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No. 22507

United States
COURT OF APPEALS
for the Ninth Circuit

3481

v. 3484

In the Matter of

PORTLAND NEWSPAPER PUBLISHING COMPANY, INC.,

Bankrupt,

R. ANTHONY DUBAY,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of PORTLAND NEWSPAPER PUBLISHING COMPANY, INC.,

Appellee.

On Appeal from the United States District Court for the District of Oregon

BRIEF OF APPELLANT R. ANTHONY DUBAY

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R. Anthony DuBay

STEVENS-NESS LAW PUB. CO. PORTLAND, ORE. 5-68

TOPICAL INDEX

STATEMENT OF THE CASE

The following chronology may be helpful in understanding this case.

1. February 8, 1960 — Portland Reporter Publishing Company, Inc. incorporated and begins publication of the "Portland Reporter," a weekly and later daily newspaper in Portland, Oregon (Ex. 2).

2. July 31, 1962—Reporter assigns to DuBay certain advertising accounts as security for DuBay's signing a collateral agreement which enabled Reporter to obtain bank credit (Ex. 16). Ledger cards of advertising accounts assigned to DuBay were marked "R.A.D." with the date of the assignment (Tr. 16-17, 40-41, 71, 96).

3. August 31, 1962—New advertising accounts assigned to DuBay (Tr. 16).

4. April 30, 1963—New advertising accounts assigned to DuBay (Tr. 16).

5. September 1, 1963—Commercial Code of State of Oregon goes into effect (Oregon Laws 1961, ch. 726, § 428).

6. September 30, 1963—DuBay and Reporter file financing statement showing assignment of accounts receivable and proceeds (Ex. 3).

7. November 30, 1963—New advertising accounts assigned to DuBay (Tr. 16).

8. December 18, 1963 — DuBay signs guarantee agreement at bank to secure further the line of credit of Reporter (Ex. 16).

9. February 24, 1964—New advertising accounts assigned to DuBay (Tr. 16).

10. March 6, 1964—DuBay and Reporter reaffirm earlier assignments of "future accounts receivable assigned or to be assigned pursuant to said agreements" (Ex. 39).

11. April 21, 1964—New advertising accounts assigned to DuBay (Ex. 16).

12. April 22, 1964—Portland Reporter Publishing Company, Inc. merged into Portland Newspaper Publishing Company, Inc. which continues to publish the "Portland Reporter" (Ex. 1).

13. September 28, 1964—DuBay and other secured creditors start to collect all accounts receivable directly from assigned advertising account debtors (Ex. 36).

14. October 15, 1964—Bankruptcy petition filed (Tr. of R. 129).

15. December 15, 1964—Trustee in Bankruptcy files petition to have DuBay and other secured creditors pay over proceeds of assigned accounts (Tr. of R. 130).

16. May 25-May 27 and June 10, 1965—Referee conducts trial (Tr. of R. 131).

17. February 9, 1966 — Referee rejects DuBay's

claim on numerous grounds, including holding that floating lien section of Uniform Commercial Code is superseded by federal bankruptcy law for accounts that become due within four months of bankruptcy (Tr. of R. 1).

18. March 11, 1966—DuBay files petition for review (Tr. of R. 65).

19. January 27, 1967—District Court hears arguments (Tr. of R. 135).

20. August 22, 1967—District Court opinion reverses Referee on validity of Uniform Commercial Code but rejects DuBay's claim on grounds that no lien on future balances in assigned advertising accounts and later assignments not in proper form (Tr. of R. 89).

21. November 7, 1967—District Court enters final order (Tr. of R. 136).

22. November 30, 1967—Appellant DuBay files notice of appeal to this Court (Tr. of R. 136).

STATEMENT OF FACTS

R. Anthony DuBay whom the Referee found to be a "public spirited citizen" (Tr. of R. 19, l. 19) was a director of Portland Reporter Publishing, Inc. (hereinafter called Reporter) from December 2, 1961 to April 22, 1964, for which he received only a nominal consideration (Ex. 2). Reporter published a daily newspaper in Portland, Oregon. On June 26, 1962, DuBay, without personal benefit to himself, signed

a collateral agreement to enable Reporter to obtain a bank loan of $25,000 (Ex. 16). Te secure DuBay against loss, Reporter by written agreement on July 31, 1962, assigned certain advertising accounts of the newspaper to DuBay. The agreement provides, among other things,

> "Whereas, Assignor desires to assign to Assignee accounts receivable which are unpaid but which are due and owing or which will become due for advertising services rendered by Assignor . . .
>
> "1. The assignee will from time to time, during the continuance of this agreement, select such accounts receivable as shall total not more than $40,000 at any one time. In the event that the total amount of the accounts at any time exceeds $40,000 then there shall be a pro rata deduction from the accounts so that the total is not more than $40,000.
>
> "4. In order to avoid objection by, and any possible loss of trade from, any of Assignor's customers, through the collection of said accounts by the Assignee direct from the debtors, it is agreed that the Assignee gives to Assignor the privilege to collect said accounts as the Assignee's agent. Upon such collection, Assignor shall, providing it is in default as defined in paragraph 7, forthwith turn over the proceeds to Assignee and Assignee shall have the full right to deposit the debtor's checks and remittances in his own bank accounts. This agency for collection may be terminated by the Assignee at any time."

Other provisions of the agreement provide for a

method of selection of the accounts, the maintenance of a level of accounts, a form of assignment, financial reporting, that assignor must accept a reassignment of accounts that cannot reasonably be collected, that assignor must "make proper entries on its books and records disclosing the assignment," that assignor was entitled to the proceeds of assigned accounts until default on the bank loan or other specified circumstances and that assignor collected the accounts for payment over to assignee upon default. Attached to the agreement is a list of certain advertisers of Reporter and an appointment by assignee of assignor "as my agent to collect said accounts and disburse the same" (Ex. 16).

The advertisers whose accounts were assigned to DuBay "were generally frequent advertisers. They were recurring" (Tr. 86, l. 18). "A majority of them would have had advertising contracts for space" (Tr. 86, ll. 21-22). Normally between the 15th and 20th of each month almost all of the bills of Reporter were paid (Tr. 28, ll. 20-21).

The assigned accounts were designated as assigned on the books of the company with DuBay's initials and the date of assignment written on the ledger card of each advertiser whose accounts was assigned. A periodic review was made of the assigned accounts and new lists of accounts were assigned on August 31, 1962 and April 30, 1963 and similarly identified on the ledger card of the specific account with the words "R.A.D." plus the date of the assignments in red ink. The controller of the company furnished

DuBay with a memorandum of the "new assignments" Tr. 16-17, 40-41, 71, 96). The assignments of August 31, 1962 and April 30, 1963 did not follow the form of assignment attached to the original agreement. They bore the typewritten signature of Keith W. Plotner, controller, but did not bear an ink signature. These assignments contained the words "the following lists of accounts receivable taken as of [date].. is to show the current standing of the original assignment of these accounts" (Ex. 16).

On September 1, 1963 the Commercial Code of the State of Oregon went into effect containing language similar in most but not all respects with the Uniform Commercial Code (Oregon Laws 1961, ch. 726, § 428). Thereafter on September 30, 1963 a financing statement signed by DuBay and Reporter was filed in accordance with Oregon law showing that the accounts receivable and their proceeds had been assigned (Ex. 3). On December 18, 1963 DuBay entered into a guarantee agreement with the bank which pledged his general assets to the repayment of the Reporter's loan. This was in addition to the collateral pledge which had been signed in June, 1962 (Ex. 16). On November 30, 1963, February 24, 1964 and April 21, 1964 numerous accounts were assigned to DuBay, similarly identified on company books with his initials and the date of the assignment, and DuBay was furnished with a memorandum of each new assignment by the controller of the company which again contained the language "the following lists of

accounts receivable taken as of [date] ________
is to show the current standing of the original assignment of these accounts" (Ex. 16, Tr. 16-17, 27, 40-41, 44-45).

DuBay terminated the company's agency for collection of his accounts on February 27, 1964 and collected all of the assigned receivables himself, along with other secured creditors until March 6, 1964 when by written agreement the agency for collection was re-established. At that time DuBay and Reporter on March 6, 1964 entered into a new agreement which provided in part as follows:

> "All agreements and assignments between the parties hereto, or any of them, are hereby affirmed and shall continue in full force and effect.
>
> "2. Without prejudice to any future rights of Davis and DuBay, and, without limiting the foregoing and without prejudice to their rights, or to the rights of either of them, to again invoke the provisions of their agreements with the Reporter, as assignor, the said Davis and DuBay do hereby release all sums heretofore collected on said accounts receivable pursuant to said assignment and once again, and until further written notice, nominate and constitute the said Reporter to be their agent and the agent for each of them for the purpose of collecting said accounts, *together with all future accounts receivable assigned* or to be assigned *pursuant to said agreements.*" (emphasis supplied) (Ex. 39).

On April 22, 1964, Portland Reporter Publishing

Company, Inc. was merged into Portland Newspaper Publishing Company, Inc. The surviving corporation assumed all of the debts and liabilities and continued to publish the "Portland Reporter" newspaper (Ex. 1).

On September 28, 1964, DuBay again terminated the agency for collection and thereafter collected along with other secured creditors all of the assigned accounts directly from the debtors of Reporter (Ex. 36). This bankruptcy petition was filed on October 15, 1964 (Tr. of R. 129). None of the collections on the accounts assigned to DuBay have to this date been surrendered to the Trustee in Bankruptcy (Ex. 39).

SPECIFICATION OF ERRORS

1. The court erred in holding that the security agreement of July 31, 1962 did not give DuBay a lien on future balances in the assigned advertising accounts.

2. The court erred in holding that the later DuBay assignments "did not even contain words of assignment or the signature of the debtor."

QUESTIONS PRESENTED

1. Did the parties to the security agreement intend to assign to DuBay the fluctuating balances in certain named advertising accounts?

2. Did the parties intend periodically to modify

the agreement by assigning new advertising accounts?

3. Did the court below ignore the intention of the parties and the course of dealing between them in rejecting the DuBay assignments?

4. Can the intention of the parties be carried out under the law of Oregon?

SUMMARY OF ARGUMENT

This appeal of R. Anthony DuBay seeks to reverse the decision of the District Court that accounts receivable which were assigned to him by the predecessor of the bankrupt up to twenty-seven months before bankruptcy are voidable preferences. To reach this result, the court held that the assignment of certain named advertising accounts did not give DuBay a lien on future balances in those accounts. The court also held that later assignments of new advertising accounts were not in proper form and did not contain the signature of the debtor.

DuBay contends:

(1) The evidence is uncontradicted that the parties to the security agreement intended to assign to DuBay the fluctuating balances in certain named advertising accounts.

(2) The evidence is uncontradicted that the parties intended periodically to modify the agreement by assigning new advertising accounts.

(3) The court below ignored the intention of the parties and the course of dealing between them in rejecting the DuBay assignments.

(4) The intention of the parties can be carried out under the law of Oregon.

ARGUMENT

I. The Court Erred in Holding That the Security Agreement of July 31, 1962, Did Not Give DuBay a Lien on Future Balances in the Assigned Advertising Accounts.

A. The evidence is uncontradicted that the parties to the security agreement intended to assign to DuBay the fluctuating balances in certain named advertising accounts.

In the newspaper business an advertising account has a well understood trade meaning. The accounts assigned to DuBay were regular, frequent, recurring advertisers, most of whom had advertising contracts (Tr. 86, ll. 18-22). These advertisers would advertise frequently, would be billed monthly and would usually pay their bill by the 15th or 20th of the following month (Tr. 28, ll. 20-21). It is clear that the parties understood that the term Montgomery Ward account (as an example of one account on the DuBay list) meant the fluctuating balance in the Montgomery Ward account. When the bill was paid monthly for the preceding month's advertising the balance would decrease. Further advertising would increase the balance in the account.

The salesman who was assigned to the Montgom-

ery Ward account was not concerned with the balance in the account at any particuar day. He had a continuing relationship with this advertising account. The continuing relationship with the major, frequent contract advertising accounts was the lifeblood of the newspaper.

This continuing nature of the account was well understood by the parties. Thus, when the controller of the company made up the later assignments he would "show the current standing of the original assignment of these accounts" (Ex. 16). The current standing was the amount that was in the account on the date of the memorandum. The controller very clearly understood and expressed in the memorandum of assignment itself that the current standing of the account on assignment date was very different from the account itself.

Just before the bankruptcy an additional assignment of accounts was made. DuBay has stipulated that this last assignment is of no effect. The testimony of the controller, however, is of considerable interest in appreciating the understanding of what was assigned. On page 20 this occurs:

> "Q. And are you speaking of the balances on October 14th on the accounts listed on April 21st?
>
> A. These are new accounts.
>
> Q. I understand. But this was to make up what you indicated was a deficiency in the accounts on the list of April 21st?
>
> A. Correct.
>
> Q. In other words, the balances owing on the

accounts included in the list of April 21st came to $35,000 minus $6,100; is that right?

A. Right." (Tr. 20)

Thus, almost six months after the assignment of April 21, the controller understood that there was almost $29,000 in the accounts assigned to DuBay. Obviously if the account only meant the then balance in the account on April 21, most of the accounts would have been paid off at the next billing period during the month of May, and by October there would have been hardly anything in the accounts assigned to DuBay.

The controller reviewed the accounts assigned every few months, removed some from the list and added others. In making this periodic review, "the first objective was to keep the accounts that had balances . . ." (Tr. 17, ll. 15-16). In a discussion of earmarking of the DuBay accounts the controller was asked these questions:

"Q. Suppose it were paid off. What did you do with the stamp on it showing assigned and 'R.A.D.'?

A. The stamp remained on the card until a new assignment, a new list of accounts was made.

Q. And this would be true even though the account had been paid off in the meantime.

A. This would be true." (Tr. 96, ll. 19-25)

Thus if new balances came into the account they would be covered by the assignment.

If anybody had ever thought that some subsequent

court would construe the Montgomery Ward account or the Safeway Stores account to mean a specific amount in the account on a specific day, then new accounts would have had to be assigned at least monthly and very possibly more frequently than monthly to maintain the $35,000 that was supposed to be assigned to DuBay.

The DuBay agreement provides that "In the event that the total amount of the accounts at any time exceeds $40,000 [later changed to $35,000] then there shall be a pro rata deduction from the account so that the total is not more than $40,000" (Ex. 16). If the parties had understood the account to be the balance on any specific day, then this language is meaningless. The parties here are saying that if the fluctuating balances in the assigned accounts exceed the agreed sum, then there shall be a reduction in the security.

The fact that the parties well understood that future balances in these accounts were being assigned by these various assignments need not be left to the mass of evidence already discussed. The agreement of March 6, 1964, the reaffirmation agreement after the Code went into effect and after the early release of receivables to the Reporter, specifically says: "*together with all future accounts receivable assigned or to be assigned pursuant to said agreements.*" The parties mentioned both "assigned" and "to be assigned" pursuant to said agreements. They thus made it absolutely clear that future accounts receivable were

being assigned pursuant to said agreements. They said so in black and white (Ex. 39).

The court's opinion stated that "the security agreement executed in July, 1962, did not give DuBay a lien on future accounts" (Tr. of R. 102). The court ignored the assignment of the fluctuating balances in the named advertiser accounts. The opinion makes no reference to the agreement of March 6, 1964 or the uncontradicted evidence throughout the transcript of the way the parties used the word "account."

B. The intention of the parties can be carried out under the law of Oregon.

The fact that the parties, Reporter and DuBay, well understood that the assignment of a specific advertising account meant the fluctuating balance in the account, which in the future might be higher or lower, seems clear. The question then arises, is there anything in the Commercial Code of Oregon which prevents the word "account" from being used in the way the parties understood it. The answer is that there is not.

The Uniform Commercial Code provides as follows:

> "1. 'Account' means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper."

Then, in Oregon law, unlike the law of any other

state that has adopted the Uniform Commercial Code, the definition of an "account" is immediately preceded with the words "unless the context otherwise requires" (Cf. UCC § 9-106 and ORS 79.1060; I Bender UCC Service 664).

In looking at the context we are also to remember that

> "(3) 'Agreement' means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in ORS 71.2050 and 72.2080." ORS 71.2010(3)

The official comment to Section 1-205:1 of the Code headed "Course of dealing and usage of trade" includes the following:

> "This section makes it clear that;
>
> "1) This act rejects both the 'lay-dictionary' and the 'conveyancer's' reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing."

The Official Comment to § 2-208:1 headed: "Course of performance or practical construction" states in part:

> "1) The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the 'agreement'."

In our case the record is replete with evidence that the parties understood that there was assigned to DuBay the fluctuating balances in the specific advertiser accounts. A similar problem arose in *In re Bergston*, 3 UCC 283 (D., Conn., 1965). Referee Seidman upheld the security agreement in that case even though the number of payments and the amount and date of each payment were not set out. The Referee stressed,

> ". . . the parties unquestionably understood the terms of the agreement, which at the time of bankruptcy had been in effect for approximately two years, during which time there was no apparent difficulty between the parties in interpreting this agreement." (3 UCC at p. 290)

Oregon law also tells us in ORS 71.1020 that

> "The Uniform Commercial Code shall be liberally construed and applied to promote underlying purposes and policies."

The case of *Rosenberg* v. *Rudnick*, 262 F. Supp. 635 (D., Mass. 1967) decided on January 18, 1967 could easily apply to our situation:

> "The transaction here was not one of those which the provisions of Sec. 60 were designed to avoid. There was nothing here in the nature of

> a secret lien. There was no attempt by one creditor to outrace others at the last moment before bankruptcy. Defendant here bargained for and acquired his security interest at the time he made his loan."

The DuBay agreement was made back in July, 1962, at a time when Reporter had a very substantial capital surplus. On December 31, 1962, some months later the Reporter had a capital surplus of $177,497 (Ex. 5) even though it had been absorbing severe losses in the initial period of publication of the new newspaper. The assignment of the accounts of certain named advertisers that was made to protect DuBay was well understood by the parties. There was never any question of the transaction which continued for a period of well over two years until the present ingenious challenge of the Trustee in Bankruptcy (Tr. 42, ll. 3-7). In refusing to let the parties define the word "account" to mean the continuing account of a named advertiser, the court took a formalistic approach which is contrary to the principal aim of the Oregon Commercial Code.

II. The Court Erred in Holding That the DuBay Assignment "Did Not Even Contain Words of Assignment or the Signatures of the Debtor."

A. The evidence is uncontradicted that the parties intended periodically to modify the agreement by assigning new advertising accounts.

The actual words of "hereby transfers, assigns and sets over" are contained in the "assignment"

which is attached to the original agreement. Later assignments do not contain these magic words but refer to the original assignment and use language such as "Accounts Receivable Assignment To Anthony DuBay, April 21, 1964" (Ex. 16). The question presented is whether calling a document an "assignment" is sufficient, or whether the verb "assign" or its equivalent must also be used (Ex. 16).

These later assignments did not follow the wording of the original assignment. The parties could vary the wording if they chose to do so. All agreements and assignments between them were reaffirmed on March 6, 1964 by the written agreement of DuBay and Reporter. In the agreement of March 6, 1964 the parties said "*together with all future accounts receivable assigned or to be assigned pursuant to said agreements.*" (emphasis added). The parties understood that these were assignments. The controller of the company so described them repeatedly in his testimony (Tr. 16, ll. 21-24; Tr. 40, l. 20; Tr. 41, l. 1; Tr. 42, ll. 3-7). Every time new assignments were made the words "R.A.D." were written and the date stamped in red ink on the ledger card of the advertiser.

The parties knew that accounts were being assigned, all creditors had notice from the financing statement which set forth the assignment of "accounts receivable" and the proceeds, and could ascertain which accounts were assigned by making inquiry of the debtor. The law requires no more.

In the case of *In re Excel Stores, Inc.*, 341 F.2d 961 (C.A.2d 1964), a security agreement was challenged on the ground that the name of the debtor was incorrect. The court said that this was in the category of "minor errors which are not seriously misleading" (341 F.2d at 962), and then stressed that, "It is clear that the parties intended to execute a valid and binding contract" (341 F.2d at 962). In our case it is clear that the parties intended to execute valid and binding assignments. There is no contrary testimony of any sort. Creditors were entitled to "the minimum information necessary to put any searcher on inquiry" (341 F.2d at 963). The information of the periodic memoranda of assignments which referred to and really incorporated the assignments on the ledger cards was available to any creditor.

B. The assignments did contain the signature of the debtor.

Oregon law provides in ORS 79.2030 that

> "a security interest is not enforceable against the debtor or third parties unless: . . . (b) the debtor has signed a security agreement which contains a description of the collateral . . .
>
> " 'Signed' includes any symbol executed or adopted by a party with present intention to authenticate a writing." ORS 71.2010(39)
>
> " 'Written' or 'writing' includes printing, typewriting or any intentional reduction to tangible form." ORS 71.2010(46)

The first assignment to DuBay includes an ink signature. Later assignments bear the typed signature,

"From Keith W. Plotner, Controller." Plotner testified that he typed these documents (Tr. 15).

In the case of *Benedict* v. *Lebowitz*, 346 F.2d 120 (C.A.2d 1965), the court upheld the typed signature of debtor on a financing statement as being sufficient, citing the Connecticut equivalent of ORS 71-.2010(39). This definition of "signed" applies throughout the Oregon Uniform Commercial Code to security agreements as well as financing statements. ORS 71.2010.

A similar holding can be found in *Plemens* v. *Didde-Glaser, Inc.*, 244 Md. 556, 224 A.2d 464 (1966).

There was in fact an ink signature on the document of March 6, 1964 which reaffirmed all of the previous assignments and this document or the ink placed on the account ledger sheets of the Reporter showing assigned and R.A.D. and the date might be construed as taking care of the problem. Actually the typed signature of the controller was sufficient. Any creditor could have ascertained which accounts were, in fact, assigned by making an inquiry. The requirements of ORS 79.2030 for a valid security agreement have been met.[1]

[1] The assignment of July 31, 1962 was unquestionably in proper form. If the District Court was not satisfied that the formal requirements had been met in the later assignments, then it should at least have recognized DuBay's claim in the continuing balances of the advertiser accounts listed on the July 31, 1962 assignment.

CONCLUSION

"Courts of bankruptcy are essentially courts of equity and the proceedings are inherently in equity." *In the Matter of Stewart*, 233 F. Supp. 89 (D., Oregon, 1964).

DuBay obtained his assignments of accounts openly and at a time when the company was solvent, long before the present bankruptcy proceedings began. He sought no financial preference or gain for himself and in fact executed the collateral agreement and guarantee without any consideration to himself. DuBay helped the general creditors by providing funds to Reporter to pay wages and bills and continue the business for an additional period of over two years.

If DuBay can overcome the objections discussed herein that his documents were not in proper form, then he stands in a position of parity with Rose City Development Company, Inc. whose secured claim was allowed by the District Court. The reasons which the District Court gave for the disqualification of DuBay are not in accordance with the liberal purposes of the Uniform Commercial Code. "Technical requirements are eliminated, pitfalls are avoided." *In re Excel Stores, Inc.*, supra, at 963 (quoting with approval the official UCC Commissioner's comment).

DuBay now seeks only to have this Court carry out the agreements that he made in good faith with

the Reporter in accordance with the law of the State of Oregon.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

DON S. WILLNER,
Attorney for Appellant
R. Anthony DuBay

No. 22507

United States
COURT OF APPEALS
for the Ninth Circuit

ROBERT J. DAVIS,

Appellant,

v.

EVERETTE H. WILLIAMS,

Appellee.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court
for the District of Oregon

HONORABLE GUS J. SOLOMON, Judge

FILED

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United States
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ROBERT J. DAVIS,
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EVERETTE H. WILLIAMS,
Appellee.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE GUS J. SOLOMON, Judge

STATEMENT OF JURISDICTION

The appellant, Robert J. Davis, hereinafter called appellant, or Davis, filed a claim as a secured claim in the bankruptcy proceeding pending in the United States District Court for the District of Oregon which commenced October 15, 1964 and is entitled "In the Matter of Portland Newspaper Publishing Company, Inc., Bankrupt, No. B 64-3282." Davis asserted a security interest in certain accounts receivable to which

claimed security interest the trustee interposed objections. After a hearing thereon, the Honorable Estes Snedecor, Referee in Bankruptcy, entered an order disallowing the appellant's claimed security interest (Transcript of Record, hereinafter Rec., 1).

Thereafter, appellant petitioned for review of the referee's order and the matter was heard before The Honorable Gus J. Solomon, Presiding Judge of the United States District Court for the District of Oregon. On August 22, 1967 Judge Solomon rendered an opinion sustaining the referee in holding that appellant's security agreement failed to comply with the requirements of the Uniform Commercial Code (Rec. 89). On November 7, 1967 Judge Solomon rendered an opinion denying appellant's claim to be subrogated and paid out of amounts payable to Rose City Development Company, Inc. (Rec. 113). A final order was entered by Judge Solomon on November 7, 1967 (Rec. 115).

This is an appeal from said orders. Jurisdiction is based upon Section 24(a) of the Bankruptcy Act, 11 U.S.C. § 47(a).

STATEMENT OF FACTS

Appellant's claim of a security interest is predicated upon an agreement dated December 13, 1963 between appellant and Portland Reporter Publishing Company, Inc., hereafter referred to as the Reporter. An assignment including a list of accounts re-

ceivable assigned were attached to the agreement, made a part thereof at the time of its execution and were covered by a single blue back. Said agreement and the attachments thereto were received as Exhibit 40; a copy appears as part of Exhibit 15. Subsequently, lists of accounts receivable assigned were prepared as of February 24, 1964 and April 21, 1964 and given appellant (Transcript of Proceedings, hereinafter Tr., 22-23). These documents are hereinafter referred to respectively as the December 13 agreement or Davis agreement, the February 24 memorandum or list and the April 21 memorandum or list.

The Reporter was later merged into the Portland Newspaper Publishing Company, Inc., the ultimate bankrupt. The facts as to the organization of the Reporter, its uncertain and threatened financial existence and the short and unsuccessful existence and demise of the bankrupt are fully set forth in the Referee's order which is before the court (Rec. 1). The transaction involving appellant and a similar transaction involving R. Anthony DuBay, hereinfter called DuBay, also an appellant, were prompted, the forms such transactions took and the manner in which they were carried on were dictated by the financial exigencies confronting both the Reporter and the bankrupt.

It is necessary for an understanding of appellant's contentions that the DuBay transaction, which occurred more than a year earlier, and the documents executed in connection therewith be reviewed.

On June 26, 1962, to enable the Reporter to obtain a loan in the amount of $25,000.00 from The First National Bank, hereinafter called the Bank, DuBay executed a collateral agreement in its favor (Rec. 19). On July 31, 1962, the Reporter and DuBay entered into an agreement (Tr. 16), a copy of which is attached to the DuBay claim, received as Exhibit 16, hereinafter called the DuBay agreement, to secure DuBay against any liability he might incur upon said collateral agreement. The agreement provided for the assignment to DuBay of certain advertising accounts receivable, hereinafter called advertising accounts, to be selected by DuBay and aggregating not more than $40,000.00 at any one time. At that time a formal assignment including a list or schedule of selected accounts was executed and made a part of the DuBay agreement. The agreement further provided in Paragraph Z for the use of similar assignments from time to time.

The only time the assignment form was used was when the DuBay agreement of July 31, 1962 was entered into (Tr. 16-17). Thereafter simple lists or schedules of assigned advertising accounts as of August 31, 1962, April 30, 1963, November 30, 1963, February 24, 1964, and April 21, 1964, were prepared (Tr. 16). The lists were in the form of memoranda, addressed to the Board of Directors, Don S. Willner, attorney, and DuBay, indicated they were from Keith Plotner, at that time controller of the Reporter and later of the bankrupt, and related to accounts receivable assigned to DuBay (Tr. 16-17).

A copy of each list was given DuBay. The lists, each of which specifically made reference to the prior lists, were typewritten and were not formally executed, nor did they bear any written longhand signatures. The actual selection of the specific accounts in the aforementioned lists was in each instance made by Plotner (Tr. 17, 45). The ledger cards covering the particular accounts selected were marked by Plotner to show their assignment to DuBay at the time the several lists were prepared (Tr. 17). DuBay did not participate in the foregoing events except to request and receive the lists of accounts receivable assigned to him.

The Uniform Commercial Code became effective in Oregon on September 1, 1963. Subsequent thereto a financing statement was executed by the Reporter and DuBay covering "accounts receivable" and duly filed September 30, 1963 (Tr. 2-3). Copies of the financing statements were received herein as parts of Exhibit 3.

On November 22, 1963, an accounts receivable loan and security agreement was entered into between the Reporter and Rose City Development Company, Inc., hereinafter called Rose City, to secure loans aggregating $55,300.00. The agreement, a copy of which was attached to the Rose City claim, received as Exhibit 17, provided for the assignment to Rose City of all accounts receivable, not otherwise identified, then existing or thereafter arising excepting accounts receivable theretofore assigned. Financ-

ing statements were duly filed and copies received as part of Exhibit 3.

On December 13, 1963, Davis executed a collateral agreement in favor of the Bank to secure an additional $25,000.00 loan by the Bank to the Reporter. (The transaction referred to in the Referee's Opinion (Rec. 27) on January 17, 1964 at which time a guaranty was executed and a savings account assigned involved a substitution of collateral, the original transaction occurring on December 13, 1963 (Tr. 419)). On the same day to secure Davis against loss the Davis agreement was executed and financing statements covering accounts receivable, copies of which were received as part of Exhibit 3 were duly filed in Multnomah County and with the Secretary of State (Tr. 2-3). The Davis agreement, hereinafter set forth, and the DuBay agreement were identical except for names, dates, the collateral agreements referred to, and one other minor item not herein relevant (See Exs. 15, 16 and 40).

The Davis agreement at the time of its execution likewise included as a part thereof an assignment, which incorporated a schedule of advertising accounts receivable as of November 30, 1963 (Tr. 68-70, Ex. 40). The schedule differed, however, in one material respect from schedules or lists of accounts assigned to DuBay which included only advertising accounts receivable. It had been originally contemplated that the accounts receivable assigned to Davis likewise would consist only of advertising accounts. However, Du-

Bay was given a preference in the selection of advertising accounts to be assigned (Tr. 75, 91).

Accordingly *it was discovered, prior to December 13, 1963* (Tr. 70-71), that the aggregate balance of the remaining advertising accounts deemed satisfactory and collectible available for assignment to Davis would be less than $35,000.00, and that *to provide Davis with a sufficient amount of accounts receivable it would be necessary to assign circulation accounts* (Tr. 69-70). Upon DuBay's unwillingness to accept circulation accounts (Tr. 70, 85) Davis agreed to accept the assignment of such accounts to supplement the difference between the aggregate of the available specific advertising accounts assigned to him and $35,000.00, said difference being $7,837.51 (Tr. 69). The inclusion of circulation accounts was discussed and agreed upon at a meeting prior to December 13, 1963, attended by Davis and Robert E. Webb, president, publisher and a director (Webb signed the December 13 agreement on behalf of the Reporter), Robley Evans, a director, and Plotner, controller of the Reporter (Tr. 85-86). Accordingly, the schedule of assigned accounts *prepared prior to December 13, 1963* (Tr. 70) (and set forth in the assignment which was part of the original Davis agreement) contained the words "circulation accounts receivable to total $7,837.51" immediately below the enumeration of the specific assigned accounts which was followed by the figure $35,000.00 (Ex. 40).

Notwithstanding the deficiency in available adver-

tising accounts receivable, the need to assign circulation accounts (Tr. 26, 69-70), the determination and agreement to include them in the security to be provided, and the aforementioned reference thereto in the schedule portion of the assignment form, *no change in language or other specific reference to the two types of accounts receivable was made* in the Davis agreement (Ex. 40).

At the same time and as part of the transaction whereby Davis undertook to guarantee the payment of the Bank's loan to the Reporter and to induce Davis to do so, on December 13, 1963, Rose City and the Reporter executed a subordination agreement to place Davis in a superior secured position (Tr. 238-239). A copy of the subordination agreement appears as part of Exhibit 15 and is set forth in the appendix.

As in the case of DuBay, the assignment form was used only at the time the Davis agreement was entered into on December 13, 1963 (Tr. 23). Thereafter, on February 24, 1964 and April 21, 1964, lists of assigned accounts receivable were prepared by Plotner (Tr. 22-26). Again these lists were in the form of typewritten memoranda from Plotner to the Reporter Board of Directors, Don S. Willner, and Davis, were indicated to be from Plotner, controller, and bore no written longhand signature (Tr. 23). A copy of each memorandum was given Davis. The specific advertising accounts receivable were selected solely by Plotner (Tr. 68-70, 76-78, 125), who properly marked the ledger cards for the specific adver-

tising accounts. No ledger cards for any circulation accounts were marked (Tr. 26, 71). At the time the February 24 and April 21 lists were prepared the aggregate of the suitable advertising accounts receivable available for assignment to Davis was substantially less than $35,000.00 and circulation accounts were necessary to provide security in that amount (Tr. 25, 69-70). Accordingly, both lists included circulation accounts for specific amounts (Tr. 25, Ex. 10).

At this point it is pertinent to note that Don S. Willner and the law firm of Lenon & Willner were very closely identified with the Reporter and Rose City and had a very intimate knowledge of its operations and financial condition (Rec. 16-17). They represented the Reporter and Rose City in the foregoing transactions and Mr. Willner also, to the extent they were represented, represented DuBay and Davis. Finally, all of the foregoing agreements, that is the DuBay agreement, the Rose City agreement, the Davis agreement and the subordination agreement, were prepared by Mr. Willner. It is further pertinent to note that because of the relationships existing between the Reporter and DuBay and Davis, who served on the Reporter's board of directors, that they were not independently represented but relied upon Willner and Reporter personnel, including Plotner, to do what might be necessary to protect their interests and take whatever steps might be required in the performance of the agreements involved.

No question was at any time raised concerning the validity of the agreements and assignments and Plotner in preparing lists was attempting to comply with the provisions of the DuBay and Davis agreements (Tr. 42-44).

Advertising accounts receivable were accounts of advertisers who more or less regularly advertised in the Reporter and, for the most part, on the basis of contracts or specific quantity space purchases. The account balances continuously fluctuated (Tr. 67, 89) as advertisements were inserted and payments made. Charges for space advertising were made on a daily basis (Tr. 67). There was no indication, nor was there any testimony to the effect that the aggregate of the balances of advertising accounts receivable was materially greater or less at any particular time, except for such variations as were related to the number of Thursdays and Fridays in a particular month and as might result from discontinuance of advertising by a particular advertiser or from inability to collect a particular account (Tr. 65, 67).

Circulation accounts were accounts of so-called district managers who dealt with delivery boys and wholesale dealers whose accounts were normally paid on a monthly basis after the close of each month (Tr. 72-73). The aggregate of circulation accounts balances peaked at the close of each month, reached some $40,000.00 to $45,000.00 or thereabouts and continued at such level right up to the close of operations (Tr. 73-74). Payments thereon were normally

made between the 5th and 10th of each month. However, the aggregate of unpaid balances upon circulation accounts was always at least $5,000.00 or more (Tr. 73) and indebtedness for the current month was accruing as payments were being made. It was estimated that the aggregate of the balances on circulation accounts, if they had been accrued on a daily basis, would on any particular date have been not less than a minimum of $15,000.00 and in all probability greater (Tr. 66, 71-75).

Exhibit 29, a summary prepared by Plotner for and introduced by the trustee, showed the balances on the specific advertising accounts contained in the Davis April 21 list on the dates of June 1, July 1, and October 1, 1964, the amounts collected as of a date near the close of December, 1964, but not otherwise specified, and the balances uncollected as of said date (Tr. 269-271).

The exhibit was prepared with reference to dates of June 1, and July 1, 1964 because of the manner in which the books and records of the bankrupt were kept and which precluded the determination of balances on June 15, 1964, which was precisely four months prior to the commencement of bankruptcy proceedings on October 15, 1964.

The exhibit indicates that the aggregate of the balances of the specific advertising accounts in the April 21 list was $18,615.45 on June 1, $16,076.10 on July 1, and $10,510.06 on October 1. The amount collected thereon as of the unspecified December date

was $7,486.85 (Tr. 270), leaving an aggregate of uncollected balances of $3,023.21, but indicated in the exhibit to be $2,420.90. Plotner testified that he regarded this amount as 70% collectible (Tr. 271).

The same exhibit showed that the aggregate balance of the circulation accounts receivable was greater than $18,852.58 on June 1, July 1, and October 1, 1964, and also that the amount collected by the unspecified date in December exceeded said sum (Tr. 273).

No testimony was offered as to the aggregate of the balances of the advertising accounts receivable in the list attached to the Davis agreement of December 13, 1963. Obviously the aggregate balance of the circulation accounts receivable was greater at all times and the amount collected exceeded the figure of $7,837.51, which, in the December 13 list was indicated as the amount necessary to be obtained from circulation accounts to provide Davis with the intended security.

Because of the Referee's ruling as to the invalidity of the Davis' security interest, no consideration was given nor determination made as to whether amounts collected upon the advertising accounts receivable listed in the schedule attached to the Davis December 13 agreement and the amount of circulation accounts therein designated should be applied upon the Davis claim as proceeds of security therefor.

Both Judge Solomon (Rec. 89) and the Referee (Rec. 1) before him disposed of the Davis claim on

the basis of there being no valid security interest and therefore gave no consideration to the question of whether, were there a valid security interest there would have been a voidable preference in favor of Davis. It is presumed that in such a situation their respective views would have been the same as to the Davis claim as they were with respect to the Rose City claim.

Judge Solomon rejected Davis's contention that on the basis of the Rose City subordination agreement he was entitled to be subrogated to its position and to be paid out of amounts payable to it on its claim (Rec. 113, 115). Although appellant's Notice of Appeal (Rec. 118) indicated that he was appealing from this portion of Judge Solomon's final order as well as the ruling on the validity of the security agreement, appellant has determined to accept the court's opinion as to the subrogation contention and is now abandoning his appeal with respect thereto. In doing so, however, appellant is not waiving or abandoning his claim to a security interest position superior to that of Rose City by virtue of said subordination agreement.

ISSUES PRESENTED

There are two basic issues presented as to appellant Davis' claim.

First, did Judge Solomon err in concluding that the Davis agreement of December 13, 1963, the assignment and schedule attached thereto and the lists

of February 24 and April 21, 1964, failed to create a valid security interest in favor of appellant Davis in certain specific advertising accounts and in the circulation accounts?

Secondly, would such security interest as may have been created in favor of appellant Davis in any of said accounts by virtue of charges which came into existence within a period of four months prior to the filing of the bankruptcy petition, run afoul of the supposed conflict between Section 60 of the Bankruptcy Act, 11 U.S.C. § 96 and UCC § 9-108 (ORS 79.1080) and be invalid as against the respondent trustee as a voidable preference?

SUMMARY OF ARGUMENT

1. Appellant Davis had a valid security interest in the balances on the filing date of the advertising accounts receivable named in the April 21 list and in the balances on the filing date of the circulation accounts.

a. The December 13 agreement, assignment and list attached thereto, and the February 24 and April 21 lists constituted valid security agreements.

National-Dime Bank of Shamokin v. *Cleveland Bros. Equipment Co., Inc.*, 20 Pa. D & C 2d 511, 1 UCC Rep. 454 (1959)

In re Platt, 3 UCC Rep. 276 (D.C., E.D., Pa. Ref. Op. 1966)

In re Platt, 257 F. Supp. 478, 3 UCC 717 (3 Cir. 1966)

In re Bengston, 3 UCC Rep. 283 (D.C. Conn., Ref. Op. 1965)

In re Lambert & Braceland Co., 29 F.2d 758 (D.C., E.D., Pa. 1928)

Lee v. *State Bank & Trust Co.*, 54 F.2d 518 (2 Cir. 1931)

Provident Tradesmen's Bank and Trust Company v. *Pemberton*, 196 Pa. Super 180, 173 A2d 780 (1961)

Benedict v. *Ratner*, 268 U.S. 353, 45 S. Ct. 566, 69 L.2d 991 (1925)

Benedict v. *Lebowitz*, 346 F.2d 120 (2 Cir. 1965)

In re Excel Stores, 341 F.2d 961, 2 UCC Rep. 316 (2 Cir. 1965)

Plemens v. *Didde Glaser, Inc.*, 244 Mc. 556, 224 A.2d 464 (1966)

National Cash Register Co. v. *Firestone & Co., Inc.*, 346 Mass. 255, 191 N.E.2d 471, 1 UCC Rep. 460 (1963)

UCC § 1-201(3) (ORS 71.2010(3))

UCC § 1-205(1), (3) (ORS 71.2050(1), (3))

UCC § 2-208(1), (2), (3) (ORS 72.2080(1), (2), (3))

UCC § 9-203(1)(b) (ORS 79.2030(1)(b))

UCC § 1-201(39) (ORS 71.2010(39))

UCC § 9-402(5) (ORS 79.4020(5))

UCC § 9-110 (ORS 79.1100)

UCC § 1-102 (ORS 71.1020)

b. The Davis security interest covered circulation accounts as well as specifically named advertising accounts.

c. Future charges and future circulation accounts receivable are covered.

In re Platt, 3 UCC Rep. 276 (D.C. E.D. Pa. Ref. Op. 1966)

2. Appellant's security interest was not invalidated as a voidable preference because charges to the advertising and circulation accounts came into existence after June 15, 1964.

Rosenberg v. *Rudnick*, 262 F. Supp. 635 (D.C. Mass. 1967)

In re Newkirk Mining Company, 54 Berks County, L.J. 179, 1 UCC Rep. 468 (1962)

In Re Goodfriend, 2 UCC Rep. 160 (D.C., E.D., Pa. 1964—apparently not officially reported)

Manchester National Bank v. *Roche*, 186 F.2d 827 (1 Cir. 1951)

In re Pusey, Maynes, Breish Co., 122 F.2d 606 (3 Cir. 1941)

Benedict v. *Ratner*, 268 U.S. 353, 45 S. Ct. 566, 69 L.2d 991 (1925)

Section 60. Bankruptcy Act (11 U.S.C. § 96)

UCC § 9-108 (ORS 79.1080)

UCC § 9-204 (2)(d) (ORS 79.2040(2)(d))

UCC § 9-205 (ORS 79.2050)

UCC § 9-303 (ORS 79.3030)

Henson, Ray D., "'Proceeds' Under the Uniform Commercial Code", 65 Col. L. Rev. 232 (1965), 2 UCC 567

Krause, Sidney, "The Code and the Bankruptcy Act, Three Views on Preferences and After-Acquired Property," 42 N.Y.U. L. Rev. 278 (1967)

"After-Acquired Property Security Interests in Bankruptcy: A Substitution of Collateral Defense of the U.C.C.," 77 Yale L.J. 139 (1967)

44 Texas L.R. 1369

Friedman, Harold, "The Bankruptcy Prefer-

ence Challenge to After-Acquired Property Clauses under the Code," 108 Penn. L. Rev. 194

Coogan, Peter F., "Article 9 of the Uniform Commercial Code; Priorities Among Secured Creditors and the 'Floating Lien'" 72 Harvard L. Rev. 838

Coogan, Peter F., "The Effect of the Uniform Commercial Code upon Receivables Financing—Some Answers and Some Unresolved Problems," 76 Harvard L. Rev. 1529

ARGUMENT

First, as to the validity of the security interest, Judge Solomon in his opinion stated that "Davis' claim, like DuBay's, must be disallowed and for the same reason" (Rec. 104). As to DuBay's claim the court observed the memoranda did not validly assign any accounts to DuBay because they did not follow the form of the executed assignment attached to the DuBay agreement, they did not contain words of assignment nor the signature of an officer of the corporation and they did not refer to future accounts (Rec. 102).

Referee Estes Snedecor in his opinion made the same observations and certain additional observations, including that the Davis agreement did not cover circulation accounts (Rec. 30-31).

Since the argument hereinafter made is so directly related to the Davis agreement, the assignment and the lists, it is desirable and necessary that said agree-

ment, the assignment and lists be set forth and they appear in the appendix hereto. Also, since such documents must be examined in terms of the provisions of the Uniform Commercial Code, the applicable provisions of the code and Official Comments thereon are likewise set forth in the appendix.

It is submitted that there is basis for holding, contrary to the decisions of both Judge Solomon and Referee Snedecor, that

(1) The Davis agreement of December 13, 1963, the assignment and list attached thereto, and the lists of February 24 and April 21 constituted valid security agreements and created a security interest in his favor.

(2) The security interest in favor of Davis covered both specific advertising and circulation accounts.

(3) The security interest in favor of Davis covered future charges to specific advertising accounts and future charges to as well as future circulation accounts.

Before proceeding to discuss, construe and evaluate the Davis security agreement documents, certain observations should be made. First, no question can be raised concerning the financing statements and the extent of their coverage. Financing statements were properly executed and filed in compliance with the applicable statute (Tr. 1, Ex. 3). They indicated the collateral to be "accounts receivable" and the proceeds

thereof. This term is sufficiently broad to include both circulation accounts and advertising accounts receivable. Moreover, it is sufficiently inclusive to extend to and cover not only such accounts at the time the financing statements were executed, but also future circulation accounts and future charges thereto and future charges to the named and designated advertising accounts. *National-Dime Bank of Shamokin* v. *Cleveland Bros. Equipment Co., Inc.*, 20 Pa. D & C.2d 511, 1 UCC Rep. 454 (1959); *In re Platt*, 3 UCC Rep. 276 (U.S.D.C., E.D. Pa. Ref. Op. 1966); *In re Platt*, 257 F. Supp. 478, 3 UCC Rep. 717 (3 Cir. 1966).

Secondly, the DuBay and Davis transactions were not the customary type of commercial transactions in which business lenders make business loans to business borrowers. On the contrary, they were transactions in which public spirited citizens, motivated by a desire to lend assistance to a struggling newspaper, which was born in the course of a strike, sought to assist the debtor in obtaining bank loans and in which the debtor sought to protect them by security interests in the only assets which it had, namely present and future accounts receivable. The Davis security agreement documents must be examined against the background of these particular transactions.

The DuBay agreement, which as noted, is for all relevant purposes identical to the Davis agreement was entered into July 31, 1962, prior to the enactment of the Uniform Commercial Code. At the time of its

execution a formal assignment, including a list of advertising accounts, was likewise prepared and executed and attached to the DuBay agreement. The assignment and list and the manner in which they were employed were again identical to those in the Davis transaction.

Between the date of the DuBay agreement and that of the Davis agreement there were two occasions, on August 31, 1962 and April 30, 1963, on which advertising accounts were selected for assignment to DuBay. Thereafter on three additional occasions, on November 30, 1963, February 24, 1964 and April 21, 1964, when selections were also made for Davis, advertising accounts were selected for assignment to DuBay. Although the DuBay agreement provided that DuBay, the assignee, would make the selection of specific accounts receivable with balances aggregating not more than $40,000 at any one time, in each instance, the specific accounts assigned were selected by Plotner, controller of the assignor, rather than by DuBay. Again, although paragraph 2 of that agreement contemplated that a formal assignment would be prepared each time accounts were selected specifically assigning such accounts, in none of these five instances was a formal assignment form used; instead memoranda containing a list of the accounts and their balances were prepared by Plotner addressed to DuBay, Don S. Willner, his attorney, and the Reporter's Board.

The particular accounts selected at the time each

list was prepared differed to some extent from the accounts included in the prior list. This was inevitable from the very nature of things, as balances in particular accounts were constantly fluctuating and were being either increased, reduced or paid off. Some advertising accounts may have been closed out or abandoned and new accounts created and again this was contemplated, as various provisions of the DuBay agreement will attest. As has been noted above, the prime consideration moving Plotner to select a particular list of accounts was to get good accounts aggregating $35,000 as of the date of selection without regard to what their balances might thereafter be.

It is submitted that the foregoing adds up to a course of dealing and course of performance with respect to the DuBay agreement, its provisions, the requirements thereof, and the parties' understandings relative thereto. See UCC §§ 1-201(3), 1-205(1) and (3), and 2-208(1), (2) and (3) and *In re Bengston*, 3 UCC Rep. 283 (D.C. Conn., Ref. Op. 1965) discussed in the Appendix at p. 21.

It is further submitted that the parties thus proceeded either as if the DuBay agreement did not contain a provision requiring the preparation of formal assignments, or as if that provision had been amended by the parties to provide that the requirements thereof would be met by the preparation and the delivery of mere lists of accounts receivable, or as if the requirements of that provision had been expressly waived. In short, it is submitted that

the preparation of lists by Plotner and their delivery to DuBay met the requirements of the DuBay agreement whatever they may be determined to be.

Davis came into the picture some sixteen months after the DuBay agreement had been entered into and after DuBay had received two lists in addition to the original assignment. The Davis agreement was prepared by the same attorneys who prepared the DuBay agreement, who represented both the debtor and DuBay (Rec. 27), and who represented Davis to the extent he was represented. By this time Davis, as well as DuBay, was a member of the Reporter's Board of Directors and likewise conversant with the situation relating to the DuBay agreement and the manner of performance thereunder. The testimony makes clear that thereafter with respect to Davis, the Reporter and its employees, particularly Plotner and Robert E. Webb, followed precisely the same course of dealing in selecting accounts to be assigned, except, of course, that circulation accounts were necessarily included, in preparing and providing lists thereof as had been followed with respect to DuBay.

In the light of the foregoing it seems quite clear that the Davis agreement must be viewed and construed whatever its specific language may be, as it was in fact viewed and construed by the parties, in the light of the DuBay agreement as supplemented by the course of dealing between the Reporter and DuBay relative thereto.

See in support of this contention *In re Lambert &*

Braceland Co., 29 F.2d 758 (D.C.E.D., Pa., 1928); *Lee* v. *State Bank & Trust Co.*, 54 F.2d 518 (2 Cir., 1931); and *Provident Tradesmen's Bank and Trust Company* v. *Pemberton*, 196 Pa. Super 180, 173 A.2d 780 (1961).

In *In re Lambert & Braceland Co.* the question concerned the rights of a creditor and the trustee to the proceeds of accounts receivable substituted by the bankrupt assignor a few days prior to bankruptcy. The assignment agreement granted the debtor the privilege "to substitute other accounts of equal amount and validity for the accounts listed in the said schedule." In practice accounts were not substituted simultaneously, but were collected, the proceeds deposited to the debtor's account without earmarking and new accounts substituted at the close of each month. The court, after pointing out that if the parties understood and agreed at the time the assignment was executed that the arrangement would be carried out in the manner in which it in fact was the transaction was void under *Benedict* v. *Rattner*, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 991, then went on to observe:

> "If, on the other hand, the original agreement required the substitutions to be simultaneous with the collection of accounts, or if (what is equivalent thereto) it required the assignor to hold the moneys collected separate and intact for the assignee's benefit until new accounts were assigned to take the place of the old, *then such agreement was clearly modified and changed by actual practice known and assented to by the assignee* . . ." (Emphasis supplied).

In *Lee* v. *State Bank & Trust Co.*, 54 F.2d 518 (2 Cir., 1931) the court, after discussing at some length the practice of the bankrupt and the defendant bank with respect to goods returned by customers whose accounts had been assigned and pledged to secure loans made by the bank, said, at p. 521:

> "Under these circumstances we cannot construe the situation as to loans made subsequent to March 13th as being other than an agreement to disregard the written requirement as to accounting for returns."

Provident Tradesmen's Bank and Trust Company v. *Pemberton*, 196 Pa. Super. 180, 173 A.2d 780 (1961), involved a security agreement containing a waiver of "all notices whatsoever in respect to this agreement." Notwithstanding the court affirmed a judgment for the plaintiff, who asserted a right to receive notice, on the opinion of the trial court judge which read in part, at p. 784:

> "In the instant case the course of dealings between the parties and the custom existing in the trade certainly justified the defendant in expecting to receive notice from the bank of cancellation of the policy of insurance. The bank receives notice from the insurer as a loss payee named in the insurance policy but the dealer as a stranger to the policy must rely on the bank to notify him so that he can protect himself by procuring new coverage.
>
> The surety agreement signed by Prusky contains a waiver of 'all notices whatsoever in respect to this Agreement' and also a provision

> that 'the undersigned's liability under this agreement is absolute and unconditional and shall not be affected or released by reason of any action taken by Bank which is hereby consented or agreed to.'
>
> It is clear that said provisions apply to the text of the agreement and do not apply to a custom or usage of the trade which is binding on the parties irrespective of said text."

Proceeding from the foregoing analysis, it would seem the memoranda of February 24 and April 21 can and should be accepted as satisfying the requirements of valid security agreements.

To have a valid and enforceable security agreement there must be at most a writing signed by the debtor and describing the collateral, UCC § 9-203(1)(b) (ORS 79.2030(1)(b)) and Official Comment thereon. It would also be necessary or at least desirable that the writing contain words of grant.

When taken in conjunction with the Davis December 13 agreement there is no question that the February 24 and April 21 memoranda meet the requirements for valid security agreements. It is arguable, however, that all these requirements were met by these memoranda themselves.

The memoranda of February 24 and April 21 certainly were writings.

Both memoranda use the term "assignment" which imports grant. The February 24 memorandum is designated "ACCOUNTS RECEIVABLE ASSIGN-

MENT TO ROBERT J. DAVIS" and indicates the following list of accounts receivable "is to show the current standing of the original assignment of these accounts. . . ." In the list of the accounts there appear two subheadings, one reading "ADDITIONAL CLASSIFIED ASSIGNED AS OF FEB. 24, 1964" and the other "ADDITIONAL DISPLAY ASSIGNED AS OF FEB. 24, 1964." Following the specific advertising accounts assigned appears the following: "ALL CIRCULATION ACCOUNTS RECEIVABLE ARE HEREBY ASSIGNED IN THE AMOUNT OF $16,690.19."

The April 21 memorandum is similarly designated "ACCOUNTS RECEIVABLE ASSIGNMENT TO ROBERT J. DAVIS" and indicates that the list of accounts receivable "is to show the current standing of the original assignment of these accounts."

While the memoranda merely indicate that accounts receivable were assigned and do not employ words such as are more customarily employed, as in the assignment form attached to the Davis December 13 agreement in which the following appears:

> "hereby transfers, assigns and sets over to Robert J. Davis, his successors and assigns, all of the right, title and interest of the Assignor"

it is submitted one looking at the memoranda would be no less aware that accounts receivable had in fact been assigned to Davis than he would be had the assignment form been used on February 24 and April 21, 1964.

The memoranda show they originated with the debtor. They bear the typewritten name of the debtor's controller. In *Benedict* v. *Lebowitz*, 346 F.2d 120, (2 Cir., 1965), a chattel mortgage was executed, together with a financing statement on the standard form, Form UCC-1. Lebowitz did not add his own signature to the financing statement because of a misinterpretation of the instructions printed at the top of the form, nor did he sign the chattel mortgage which was the security agreement and which was filed together with the financing statement. Since neither document was signed, the question before the Referee was whether, in view of the circumstances obtaining, "the insertion of Lebowitz's name in the body of the financing statement constituted a 'signing' by him within the meaning of 'the statute'." The court held, along with the Referee and the lower court that Lebowitz had signed the financing statement in the manner required by law. In support of its decision, the court said at page 122:

> "Referee Trevethan cited Conn. Gen. Stat. § 42a-1-201(39) (Uniform Commercial Code § 1-201 (39)), which provides: '"*Signed*" *includes any symbol executed or adopted by a party with present intention to authenticate a writing.*' With regard to the requirement that a symbol be affixed to the writing, the referee referred to the comment by the authors of the Uniform Commercial Code that the symbol 'may be printed, stamped, or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead.' As for the requirement

that there be an intention to authenticate the writing, the referee stated that this simply meant an intention 'to evidence or establish its genuineness.'

Referee Trevethan held that 'the act of Lebowitz's secretary in typing his name on the financing statement at his direction, coupled with his subsequent act of filing the statement, constituted Lebowitz's effort and indicated his intention to authenticate the statement, i.e., to establish it, so far as Lebowitz was concerned, as the genuine financing statement of the transaction.' The referee noted that Lebowitz neglected to inscribe his signature at the bottom of the financing statement as well, only 'because of his misunderstanding of the instructions' of Form UCC-1. The referee added that Lebowitz's 'filing of the chattel mortgage * * * with the financing statement serves quite abundantly further to demonstrate that the financing statement was an honest, genuine statement of Lebowitz.' "

It would seem that the selection of the accounts to be assigned, their identification by appropriate marking on the ledger cards, and the preparation of a memorandum containing a list of said accounts and of their balances, all such acts being performed by the controller, coupled with the fact that the memorandum indicates it is addressed to the Reporter's Board of Directors, among others, and is from its controller whose name appears thereon, together add up to an indication of the *Reporter's intention to authenticate the statement,* to follow the language of the court in *Benedict* v. *Lebowitz,*—that is to establish it as a gen-

uine security agreement—and this is all that UCC § 1-201(39), (ORS 71.2010 (39)) requires.

The fact that in *Benedict* v. *Lebowitz* a financing statement was involved rather than a security agreement in this instance does not weaken appellant's contention in any way. Because of its function to give notice it would seem far more important that a financing statement than a security agreement strictly comply with the statutory requirements as to signing. In any event there is nothing in UCC § 1-201(39) (ORS 71.2010(39)) to suggest that the definition of signing applies to a financing statement but not a security agreement.

Other cases, all involving financing statements—apparently there are none involving security agreements—in which "signings" other than in precisely accurate manner were held not to defeat the security interest of the secured party are: *In re Excel Stores*, 341 F.2d 961, 2 UCC Rep. 316 (2 Cir. 1965); *In Re Bengston*, 3 UCC Rep. 283 (D.C., Conn. Ref. Op. 1965); *Plemens* v. *Didde Glaser, Inc.*, 244 Md. 556, 224 A.2d 464 (1966). These cases refer to UCC § 9-402(5) (ORS 79.4020(5)) and reflect the apparent policy of courts generally in applying the UCC to disregard minor errors or deviations which are not seriously misleading.

As to the description of the collateral, the specific advertising accounts receivable assigned are identified by names and balances as of a specified date. Circulation accounts are designated as such. Accordingly,

there appears to be no question whatsoever that the collateral was reasonably identified so as to satisfy the statutory requirements.

The courts have applied UCC § 9-110 (ORS 79.1100) consistently with the policy as set forth in the Official Comment. It should further be emphasized that the Uniform Commercial Code, as UCC § 1-102 (ORS 71.1020) provides, is to be liberally construed and applied, among other purposes, "to simplify, clarify and modernize the law governing commercial transactions." For this purpose the Code introduced notice filing. Notice to creditors is effected by the filing of a financing statement providing a creditor with only the minimum information necessary to enable him to make inquiry of either the secured party or the debtor to learn the nature, extent and other details regarding the security. Thus, in *National Cash Register Co.* v. *Firestone & Co., Inc.*, 346 Mass. 255, 191 N.E.2d 471, 1 UCC Rep. 460 (1963), the security agreement covered the business at a stated address "together with all its good-will, fixtures, equipment and merchandise. The fixtures specifically consist of the following: All content of luncheonette including equipment such as: booths and tables" followed by a number of specifically designated items, not including a cash register which was delivered after the security agreement was executed. The court quoted from UCC § 9-110 (ORS 79.1110) and UCC § 9-203 (ORS 79.2030) and then said:

> "contrary to the plaintiff's contention, we are of the opinion that the security agreement is broad

> enough to include the cash register, which concededly did not have to be specifically described. The agreement covers 'All contents of luncheonette including equipment such as,' which we think covers all those contents and does not mean 'equipment, to wit.'"

In *National-Dime Bank of Shamokin* v. *Cleveland Bros. Equipment Co., Inc.*, 20 Pa. D. & C.2d 511, 1 UCC Rep. 454 (1959) defendant claimed the description of a certain "Unit" Model 614 backhoe or shovel was not only insufficient but misleading. The court after quoting from UCC § 9-110 (ORS 79.1100) and the Official Comment thereon said:

> "We think the description of the backhoe or shovel in the instant case 'reasonably identifies the thing described' (Section 9-110 of the Uniform Commercial Code, 12A Purdon's Penna. Statutes, Sec. 9-110, supra) and that this item was sufficiently described to identify it without the aid of the serial number. We believe that the defendant was put on notice that the equipment belonging to Harry D. Reitz was subject to security interests. It had notice of the parties who held the security interests and it was under a duty to inquire as to whether or not the equipment with which it was dealing was subject to such a security interest."

And see *In re Excel Stores*, 341 F.2d 961, 2 UCC Rep. 316 (2 Cir. 1965); *In re Platt*, 3 UCC Rep. 276 (D. C., E.D., Pa. Ref. Op. 1966) and the same case on appeal 257 F. Supp. 478, 3 UCC. Rep. 717 (D.C., Pa. 1966).

If a creditor did in fact make inquiry would the security agreement or the lists have been exhibited to him? It is doubtful. More likely the secured party or the debtor, as the case may be, would have advised that the secured party had a security interest in the designated advertising accounts and in circulation accounts. If the secured party or the debtor had in fact exhibited the lists to the creditor, would not the creditor have been informed as to what the claimed security interest of the secured party was? The answer is, obviously so. Could the creditor have thereafter contended that he did not know what accounts receivable the secured party had had, or at least claimed to have had, assigned to him?

The referree and the trustee appellee recognized that the Davis December 13 agreement, and the assignment and list attached thereto, coupled with the proper filing of the financing statements, created a security interest in favor of Davis in the advertising accounts receivable therein specified to the extent of the then outstanding balances although disputing any security interest in future balances and circulation accounts (Rec. 33). Thus the trustee in contending and Judge Solomon and Referee Snedecor in holding that appellant Davis did not have a valid security interest are, in effect, stating that an inquiring creditor could have requested he be shown the Davis agreement, the February 24 and April 21 lists, and then after having seen them, have concluded that he could safely ignore the financing statement and Davis' claimed security interest in the specifically des-

ignated advertising accounts and in the circulation accounts because the February 24 and April 21 memoranda were not in the proper assignment form, did not contain formal words of grant and bear a longhand signature on behalf of the Portland Reporter Publishing Co. The mere statement of this conclusion is sufficient to demonstrate its invalidity.

Were circulation accounts covered? Judge Solomon in his opinion notes that appellant Davis "contends that he is entitled to circulation accounts totalling $18,752.58, the amount of the circulation accounts listed on the April 21, 1964 memorandum" (Rec. 104). It is not clear from the following sentence in that opinion whether he is of the view that circulation accounts were not covered by the Davis security agreement or that the particular circulation accounts were not covered because of their after-acquired nature. Referee Snedecor left no doubt on this score and categorically stated that the purported security agreement was limited to advertising accounts (Rec. 30).

It is true that the first WHEREAS clause of the Davis agreement, which is a poorly drafted and somewhat incomplete document with ambiguous and conflicting language, makes reference solely to accounts receivable for advertising services. However, as the testimony showed (Tr. 69-70), before the Davis agreement was executed it was discovered that it would be necessary to assign circulation accounts to him to provide him with the $35,000.00 minimum amount of

accounts receivable. Moreover, as noted, it was specifically determined at a meeting between Davis and officials of the Reporter including Robert E. Webb, the president, who signed the December 13 agreement, that circulation accounts would be included (Tr. 85-86). Thus the list of accounts attached to the assignment and made a part of the Davis agreement specifically showed that circulation accounts were assigned for the amount of $7,837.51, although the agreement itself was not specifically amended.

However, the assignment and list were attached to, and together with, the Davis agreement constituted a single instrument and must be so read. In view thereof and the determination of the parties at their meeting before the December 13 agreement was executed the recital in the first WHEREAS clause can not be construed as excluding circulation accounts, but the agreement must be deemed to have been amended to provide that Davis acquired a security interest in the specific advertising accounts designated and in all circulation accounts; albeit the extent of his security interest in all circulation accounts may have been limited to the amount by which the aggregate of the balances of the specific advertising accounts was less than $35,000.00. Thus, it is almost as if appellant Davis had a two-part security interest—one part in the designated advertising accounts for the full balances of said accounts, and separately therefrom, a second part in all circulation accounts in an amount equal to the difference between the

aggregate of the balances of the designated advertising accounts and $35,000.00.

The Referee's observation that a creditor looking at the Davis agreement would have no reason to assume that he had a security interest in the circulation accounts is not correct. A creditor would have to look at the whole agreement, including the assignment and the list as a part thereof, which clearly spelled out circulation accounts. Certainly inquiry of either the secured party or the debtor would have removed any possibility of doubt. Nor would the financing statement serve as a basis for denying a security interest in circulation accounts as they come within the term "accounts receivable."

As to Judge Solomon's and the Referee's observation that the Davis agreement did not extend to future accounts, some clarification is necessary. A distinction must be made between advertising accounts and circulation accounts. Appellant concedes that *it was not intended he have a security interest in advertising accounts receivable created in the future*, that is accounts of advertisers, *other than those specifically named* in the lists from time to time provided him. At the same time appellant Davis contends that *it was intended he have a security interest in all future charges, if any, to such named accounts.* Thus, paragraph 1 of the December 13 agreement makes reference to the selection of such accounts receivable as shall total not less than $35,000.00 nor more than $40,000.00 at any one time and further states "In the event that the total amount of the accounts *at any*

time exceeds \$40,000.00, then there shall be a prorata deduction from the accounts so that the total is not more than \$40,000.00." (italics supplied). This possibility could occur only if there were future charges to such accounts and such charges were taken into account. If what was intended was that the security interest extend only to the balances of named or selected accounts existing at the time of selection, then obviously the sentence quoted was unnecessary, because at the time of selection there would be no difficulty in determining what the balances of selected accounts were and in selecting accounts the aggregate of whose balances did not exceed \$35,000.00. (Although the agreement used the figure \$40,000.00, it was never intended to provide more than \$35,000.00 of accounts receivable (Tr. 69, 91)). As a matter of fact Plotner testified that in selecting accounts for the lists prepared by him he was concerned only with getting good accounts which aggregated \$35,000 at the time of selection regardless of "what the balances would be today, tomorrow, the day after tomorrow, or a month from today" (Tr. 93-94).

It is further appellant's contention that the agreement being deemed amended to included circulation accounts must also be construed as giving him a security interest in all circulation accounts, including future accounts as well as future charges to circulation accounts existing on April 21, 1964. Appellant categorically rejects the Referee's suggestion that only circulation accounts in existence at the time a particular list was prepared and the balances owing were

covered at most. No attempt was made to designate or otherwise limit circulation accounts in the references thereto in the lists. The only limitation was the portion of the $35,000 total security which was collateralled by circulation accounts, such amount being that shown from time to time in the lists provided Davis. In this respect the designation of circulation accounts, as extending to all circulation accounts, was no more circumscribed than was the designation of accounts receivable in the assignment to Rose City.

Moreover, the security interest obtained by appellant Davis would have been well nigh worthless if it was confined to balances of specific accounts at the time they were selected. These accounts were continuously revolving—that is payments were made and new charges incurred. Conceivably the balance in a particular account might be reduced or paid out between the time the account was examined and marked by Plotner and the time a particular list was prepared and delivered to Davis. Obviously to make the changes in the lists necessary to include future charges would have been extremely burdensome particularly since charges in the advertising account balances were occurring daily. It is inconceivable that a new list or assignment would have to be prepared each day. The enormity and unreasonableness of such a burden or requirement was recognized by the court in *In re Platt*, 257 F. Supp. 478 (D.C. Pa. 1966) 3 UCC Rep. 717, in which the collateral was described in a financing statement as "Inventory and Accounts Receivable" without using the word "future." Thus the court said at page 720:

"*A detailed description of the collateral in the case of accounts and inventory would require the filing of daily statements.* The addition of the word 'future' to 'accounts receivable and inventory' would not seem to help an interested party in determining the status of the debtor." (Emphasis supplied)

Appellant Davis in the foregoing argument has made reference to both the February 24 and April 21 memoranda and lists, as well as to the assignment and list which were part of the December 13 agreement without indicating upon which of them his claim was based. However, appellant relies in his claim to a security position upon the advertising accounts and the proceeds thereof listed in the April 21 memorandum and upon the circulation accounts and proceeds thereof to the amount set forth in that memorandum, namely $18,752.58. On the other hand, if the court should reach the conclusion that the February 24 and April 21 memoranda and lists were of no effect and validity as security agreements, then appellant Davis contends that he should be able to recover upon the assignment dated December 13, 1963, at least to the extent of the security, namely $7,837.51, for which circulation accounts were assigned since the validity of the December 13, 1963 agreement and the assignment attached thereto admittedly created a valid security agreement.

Appellant therefore urges the court to hold the April 21 memorandum is to be read together with the Davis December 13 agreement and, on the basis

of the foregoing analysis, constituted a valid security agreement covering both specific advertising accounts named in that memorandum, including future charges thereto and all circulation accounts and charges thereto including future accounts. However, with reference to circulation accounts appellant claims a security interest only in the maximum amount of $18,-752.58, or possibly, in the alternative at least to the extent of $7,837.51) and admits that beyond said sum he must look to the proceeds collected upon the advertising accounts named in the April 21, 1964 list.

The second issue presented is whether—if it be assumed a valid security interest was created in favor of appellant Davis—the charges to the advertising accounts in the April 21 list and to the circulation accounts which came into existence after June 15, 1964 are to be deemed transfers for an antecedent debt coming within the four month period prior to the filing of the bankruptcy petition and therefore voidable preferences as against the trustee.

As noted neither Judge Solomon nor the referee considered this question insofar as it related to appellant's claim. Referee Snedecor conceded that value was given by Davis and a security interest in his favor was created on December 13, 1963 (Rec. 33). Nonetheless it must be presumed that Referee Snedecor would have ruled against Davis with respect to accounts receivable balances and charges created after June 15, 1964 just as he did with respect to the Rose City claim (Rec. 43). On the other hand it must be

presumed that Judge Solomon, had he recognized the security interest in favor of Davis, would have held that such security interest was not affected by the voidable preference problem.

On this hypothesis it would seem this issue is not one for argument in the first instance by this appellant, but rather should first be argued by appellee and then be for response by appellant. It would seem, however, that certain observations as to the fact situation obtaining and perhaps brief argument are in order.

The advertising accounts involved were not isolated accounts with isolated charges arising in the course of isolated transactions. On the contrary, they were not only selected by the controller but were to some extent a selected group, that is, they were accounts which he felt were satisfactory and collectible. The balances on advertising accounts fluctuated daily; there were a multitude of new charges to such accounts, including those in and not in the Davis and DuBay lists, each and every day the newspaper was published. Likewise, the balances of the circulation accounts fluctuated daily. While no specific evidence relative thereto was introduced it appeared to be implicit that payments for advertising space and collections from circulation dealers were received virtually every day the business office was open.

The aggregate of charges made and payments received may not have been identical on a daily basis and on some days may have been at substantial var-

iance one to the other, but over the period of operations were on balance substantially equivalent, although Exhibit 29 discloses that the balances on the advertising accounts specifically named in the Davis April 21 list steadily declined from that date to the filing date. Nevertheless, at all times the aggregate of the balances of these specific advertising accounts, plus $18,742.58, the maximum amount to which the circulation accounts were assigned to Davis, was in excess of the indebtedness to him both at the commencement of the four month period and at the filing date.

Let us sharpen the issue. First, Davis concedes that the bankrupt was insolvent on June 15, 1964 and that he was charged with knowledge thereof. Secondly, Davis agrees that the only time that new value—as distinguished from the substitution of value for value—was given by him was on December 13, 1963 when he first guaranteed the Reporter's obligation to the bank. Thirdly, Davis contends that his security interest covered the balances on October 15, 1964 of all advertising accounts specified in the April 21 list (but no other advertising accounts) and of all circulation accounts to the maximum amount of $18,752.58, without regard to when such circulation accounts were created. Thus, Davis contends that his security interest extended to and encompassed any and all charges to the named advertising accounts and to any and all circulation accounts after June 15, 1964, hereinafter called the post-June 15 charges. Davis further

contends that in view of UCC § 9-108 (ORS 79.1080)* *and the circumstances obtaining,* his security interest was perfected on December 13, 1963 when the agreement of that date was entered into and, accordingly, his security interest effectively attached to the post-June 15 charges upon their coming into being. And he so contends notwithstanding that the bankrupt acquired no rights in the specific post-June 15 charges until they came into being and that under the strict interpretation of the language of UCC § 9-204(2)(d) (ORS 79.2040(2)(d)) it may be contended Davis did not acquire any security interest therein until such time.

The trustee on the other hand contends that the transfers by which such post-June 15 charges became subject to the Davis security interest occurred within the four month period; that during such period the bankrupt was insolvent and to appellant's knowledge; moreover that the indebtedness which said transfers were designed to secure was antecedent, notwithstanding UCC § 9-108 (ORS 9.1080); and that the effect of allowing Davis to claim a security interest in such charges would be to give him a greater percentage of his debt than other creditors of the same class and thereby give him a preference. The trustee further argues that UCC § 9-108 (ORS 79.1080) is in conflict with Section 60 of the Bankruptcy Act and that the Bankruptcy Act prevails. Accordingly, it is the trustee's position that such preference is voidable

* The relevant provisions of the Bankruptcy Act and the Uniform Commercial Code appear in the appendix.

under the provisions of Section 60(a) and (b) of the Bankruptcy Act (11 U.S.C. § 96(a) and (b)).

The referee stated the question to be as follows (Rec. 43):

> "The question posed is whether the perfection of security interests in accounts coming into existence within four months of the bankruptcy may constitute preferential transfers under the prescribed conditions of Section 60 of the Bankruptcy Act."

He then accepted the contentions of the trustee. He was of the view that Section 60 of the Bankruptcy Act and UCC § 9-108 are in conflict, and further, that under UCC 9-204(2)(d) a security interest in accounts receivable can not be perfected until the accounts or the charges thereto come into existence. Accordingly, the referee held that to attach a security interest to charges generated within four months of the bankruptcy filing date would constitute a voidable preference. As a result he expressly disallowed the security interest of Rose City and implicitly disallowed that of Davis.

The only case, other than the instant case, in which the question of the alleged conflict between Section 60 of the Bankruptcy Act and UCC § 9-108, and the validity of the so-called "floating lien," was definitely litigated is *Rosenberg* v. *Rudnick*, 262 F. Supp. 635 (D.C., Mass. 1967).

That case squarely raised the issue as to whether a security interest, "in all the equipment, machinery,

fixtures, inventory and accounts receivable of the debtor, together with all additions thereto and all property now or hereafter substituted therefor and otherwise acquired in the ordinary course of business" effectively covered inventory acquired and accounts receivable arising within the four month period. The trustee, in that case, made the same contentions as were made by the trustee in this one. The court pointed out what a trustee must prove under Section 60 of the Bankruptcy Act to establish a preferential transfer, noted there was no question as to the insolvency of the debtor, the creditor's knowledge thereof and the so-called "antecedent" character of the indebtedness and then stated the problem as follows, at p. 637:

> "The serious question here, however, is when the transfer of debtor's property to Rudnick should be deemed to have taken place. If, as Rudnick contends, the transfer took place with the execution of the security agreement on April 30, 1962 then it took place prior to the four month period preceding bankruptcy, contemporaneously with the creation of the debt, and had the effect of giving Rudnick the status of a secured creditor rather than giving him an improper advantage over other general creditors."

The court observed that the time of transfer must be determined in accordance with Section 60 of the Bankruptcy Act, called attention to the trustee's reliance on UCC §§ 9-204 and 9-303, the same sections relied upon by the trustee in this instance, and went on to say, at p. 638:

"A first literal reading of these provisions would seem to support the trustee's contention. However, § 60(a)(2) does not make the test one of when the state law may denominate a security interest as perfected. The specific test of § 60 (a)(2) is one of when under state law the security interest, however described, becomes one which cannot be defeated by a subsequent lien obtainable in proceedings on a simple contract action. Perfection under state law need not be full perfection but only perfection *so far* as is necessary to meet the test of § 60(a)(2) [Emphasis by Court] * * * Such a lien, after proper compliance with the filing provisions, is superior to a subsequently acquired contract creditor's lien or other claims of third parties except the rights of buyers in the ordinary course of business under § 9-307(1) and holders of perfected purchase money security interests under § 9-312 (3). *In this case the security interest was created by the execution of the security agreement on April* 30, 1962 *and the subsequent compliance with the filing provisions. As of that date the security interest met with the requirements of* § 60(*a*)(2) *and the transfer must be regarded as having taken place on that date.*" (Emphasis supplied)

The court further indicated that UCC § 9-108 presented a different approach to the problem but would have produced the same result. The court, after noting that the validity of that provision had been questioned, said at p. 639:

"Under the Bankruptcy Act the definition of what constitutes an antecedent debt is not one to

> be determined by state law. The Bankruptcy Act itself does not define antecedent debt. In view of the fact that the Uniform Commercial Code has now been adopted by 48 states, it would seem that the definition of § 9-108 should be regarded as generally accepted and in accord with current business practice and understanding and hence applied in bankruptcy. *In any event, even if the definition adopted by § 9-108 is not accepted, the section clearly shows that the intent of the Uniform Commercial Code is that a transfer such as the one involved here should not be considered a preferential one,* and the Code's provisions as to perfection and attachment of security interests should not be interpreted to produce a different result." (emphasis supplied)

The only other cases which would seem to cast any light whatsoever upon the problem are those of *In re Newkirk Mining Company*, 54 Berks County, L.J. 179 1 UCC Rep. 468 (1962), and *In re Goodfriend*, 2 UCC Rep. 160 (D.C., E.D. Pa. 1964—apparently not officially reported). In *In re Newkirk Mining Company* a reclamation petition was filed based upon a security agreement which covered "inventory, now or hereafter acquired, used and produced by Buyer in connection with and as a result of mining operations." It did not appear when the after acquired equipment and inventory was acquired. The trustee contended that after-acquired property could not be claimed under the security agreement.

Referee Hiller allowed the reclamation petition, called attention to UCC § 9-108 and the attempt to

avoid conflict with Section 60 of the Bankruptcy Act and said in part at p. 469:

> "I have no trouble in *finding that this petitioner's security interest* in 'equipment' and 'inventory' *extends to after-acquired 'equipment' and 'inventory'* under the explicit provisions of the Agreement itself and that the description of the property contained in Exhibit A of the Security Agreement includes furniture and fixtures. *This will include all after-acquired office furniture and fixtures.*" (emphasis supplied)

In *In re Goodfriend* the security agreement was entered into in connection with the sale of "Kiddy & Women's Wear Shop" and provided that the inventory would constantly be maintained in a minimum amount. The district court upheld the security interest in after-acquired inventory and with reference thereto stated, at p. 161:

> "The language employed clearly created a security interest in the whole inventory. The provision that the inventory was 'to be maintained' at a certain value can only be read to mean that *future items added to the inventory were to be included in the lien.*" (emphasis supplied)

While neither of these cases can be cited as a square holding because of the absence of certainty of the acquisition dates of the after-acquired property both involved inventory. In *In re Goodfriend* inventory must inevitably have been acquired within four months of bankruptcy unless there was a complete cessation of business operations during said period and in view of

the nature of the business this was entirely unlikely. Whether inventory in the *Newkirk Mining Company* case was acquired within four months of bankruptcy may be less certain although it is likely inventory purchases were being made until bankruptcy or shortly prior thereto. It should further be noted that Referee Hiller made no reference to any limitation of time of acquisition and specifically indicated that all after-acquired office furniture and fixtures were included.

An examination of the numerous law review articles and other writings concerning the subject indicates that three theories have been advanced to sustain the floating lien. One is the entity or unitary theory, the second the substituted collateral theory, and the third the automatic perfection theory. The first was expounded in an article by Ray D. Henson entitled " 'Proceeds' Under the Uniform Commercial Code" in 65 Co. L. Rev. 232 (1965), 2 UCC 567. This theory had been given recognition by Judge Magruder in *Manchester National Bank* v. *Roche,* 186 F.2d 827 (1 Cir. 1951) at page 831 where the following appears:

> "Second, it is not without significance that in Section 1 of C. 262-A the New Hampshire legislature specifically provided that the lien on merchandise would be valid from the time of filing the precribed notice 'whether such merchandise shall be in existence at the time of the agreement creating the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower.' In other words, the

res which is the subject of the lien provided in Section 1 is *the merchandise or stock in trade, conceived of as a unit presently and continuously in existence — a 'floating mass', the component elements of which may be constantly changing without affecting the identity of the res.* Cf. Hopkins v. Baker Bros. & Co., 1894, 78 Md. 363, 28 A. 284, 22 L.R.A. 477; Pullman's Palace Car Co. v. Pennsylvania, 1891, 141 U.S. 18, 26, 11 S. Ct. 876, 35 L. Ed. 613. So conceived, it is not inconsistent with the existence of the lien or floating charge on the inventory, as it may be made up at any particular time, that the borrower is free to withdraw an item from stock for sale in the regular course of business, without any obligation to account to the lien holder for the proceeds." (emphasis supplied)

The substituted collateral theory has been urged by Sidney Krause in "The Code and the Bankruptcy Act, Three Views on Preferences and After-Acquired Property," 42 N.Y.U. L. Rev. 278 (1967), and in a lengthy and well-reasoned note in 77 Yale L.J. 139 entitled, "After-Acquired Property Security Interests in Bankruptcy: A substitution of Collateral Defense of the U.C.C." It is also discussed by Henson in the Law Review article previously cited. It has been said that UCC § 9-108 is a codification of this theory, 44 Texas L.R. 1369, citing Gilmore. This theory also influenced Judge Ford in *Rosenberg* v. *Rudnick*.

There would seem to be ample basis for applying the substituted collateral theory to the situation at hand. The balances owing upon the advertising and

circulation accounts were constantly fluctuating with daily charges and virtually daily payments. Referee Snedecor had recognized that if these substitutions occurred through some controlled or policing procedure which would account for the proceeds there would have been no preference problem or question concerning the validity of the security interest on charges arising within the four month period (Rec. 36). (See *In re Pusey, Maynes, Breish Co.*, 122 F.2d 606 (3 Cir. 1941) in which substitutions through a controlled procedure were upheld notwithstanding some question as to complete simultaneity and contemporaneity.) The bankrupt here was not required to account for the proceeds. However, this fact should have had no effect in view of UCC § 9-205 (ORS 79.2050) which expressly repealed *Benedict* v. *Ratner*, supra.

To have required policing or the use of some other procedure whereby accounts receivable were released and new accounts receivable assigned and appropriate documents provided and executed as charges and balances were paid and new charges and balances created would have been exceedingly burdensome. For all practical purposes there were virtually automatic substitutions of new charges for prior charges which were paid and satisfied and on a more or less simultaneous basis. What the Uniform Commercial Code has done is to permit what might be termed an automated substitution process to replace the pre-Code circumscribed procedures.

The third theory, the so-called automatic perfection theory is expounded at some length by Harold Friedman in an article entitled "The Bankruptcy Preference Challenge to After-Acquired Property Clauses under the Code", in 108 Penn. L. Rev. 194, and particularly at p. 214.

Aside from the foregoing theories there are other considerations which dictate sustaining Judge Solomon with respect to the voidable preference question. As both he and Judge Ford in *Rosenberg* v. *Rudnick* pointed out the Uniform Commercial Code has been almost universally adopted. It was designed among other purposes to avoid the *Benedict* v. *Ratner* doctrine, the limiting effects of which had been nullified by factors lien acts, the Uniform Trust Receipts Act, and field warehousing and flooring plans, and other statutory provisions upon and from which the "floating lien" and portions of article 9 are based or derived. See Friedman, op. cit. p. 214 and Peter F. Coogan "Article 9 of the Uniform Commercial Code; Priorities Among Secured Creditors and the 'Floating Lien'" in 72 Harvard L. Rev. 838, p. 843.

Obviously the Uniform Commercial Code was not intended to do away with the objectives and results obtained by such statutes and procedures, but on the contrary to build thereon and to preserve and expand the freedom and flexibility in financing arrangements thus achieved. Clearly the Uniform Commercial Code should be interpreted to continue and promote such freedom and flexibility.

Secondly, the policy underlying the enactment of Section 60 and the objective of its provisions against voidable preferences, namely to prevent one creditor from obtaining a disproportionate share of the total assets of the bankrupt and diminishing the estate which other creditors have a reasonable basis for believing will be available for distribution to them on a prorata basis, are not vitiated by giving effect to the floating lien. Because of notice filing, creditors are apprised of the fact, where the financing statement indicates that inventory and accounts receivable are subject to a security interest, that these assets will or may not be available for distribution to them. Again, where new inventory is acquired with the proceeds of inventory sold or where accounts receivable continually revolve there is in fact no diminution in the estate available for ratable distribution to general creditors—or at the very least no diminution in any way attributable to such security interest.

That the policy behind Section 60 does not require the invalidation of the floating lien upon inventory or accounts receivable created within the four month period is indicated by Coogan in another aritcle entitled "The Effect of the Uniform Commercial Code upon Receivables Financing — Some Answers and Some Unresolved Problems," 76 Harvard L. Rev. 1529. Thus, the footnote appearing at page 1549 reads as follows:

> "While the senior author would not advise a secured party to rely on 9-108, he can see how *a court which looks to the real purpose* of section

> 60 of the Bankruptcy Act *could say* that *the transaction* involved in the typical factual situation where 9-108 would be invoked *is not within the mischief section 60 is intended to cover.*" (emphasis supplied)

Section 60 is directed to a situation in which a creditor either receives a payment on account or gets new and additional security or by some other positive act is placed in a position superior to that previously held, and thus preferred as against other creditors. In the floating lien situation the indebtedness to the creditor has not been reduced, the security available is not increased or added to, nor have any other steps been taken to place the creditor in a better position than he otherwise would have been. The vice against which Section 60 is directed has not happened. All that has happened is that some inventory has been replaced by other inventory of an equivalent, or perhaps lesser but not greater, amount, or that accounts receivable or balances of particular accounts receivable have been replaced by other accounts receivable or balances of an equivalent, or perhaps lesser but not greater, amount; and this results almost automatically from the mere continuance of the debtor's operations in a normal and customary manner.

To disallow the floating lien on replacement inventory and on new charges to accounts receivable would be to deprive secured creditors of valid and enforceable liens and security interests which they had at the commencement of the four month period, and do so without fraud, collusion, connivance, or im-

proper conduct of any kind on the part of the creditor and debtor. It would compel them, to prevent this unfortunate result, to enforce their security interests at the first hint of financial distress and perhaps precipitate liquidation and bankruptcy where patience and consideration might enable, or at least afford time for, a burdened debtor to work out of his difficulties. It is clear that if a creditor proceeds to enforce and bankruptcy and liquidation follow no preference will or can result. To argue that the contrary is true and that the creditor will derive a preference if he permits the debtor to continue operations seems utterly indefensible. It is obvious that the Uniform Commercial Code should not be so construed.

Accordingly, it is submitted that the court should resolve the second issue dealing with the question of the preferential character of the transfers resulting from extending appellant's security interest to post-June 15, 1964 charges in his favor.

CONCLUSION

Appellant urges the Court to conclude that he acquired an effective, valid and enforceable security interest in the balances at the filing date in all advertising accounts receivable specifically named in the April 21 list and in all circulation accounts, to the maximum amount of $18,752.58, and to the proceeds thereof, and also that such security interest was not invalidated as a voidable preference by the pro-

visions of Section 60 of the Bankruptcy Act of charges to such accounts after June 15, 1964. Appellant further urges the Court, on the basis thereof to reverse the order of Judge Solomon with respect to appellant and to direct that judgment by virtue of the December 13 agreement, the assignment and list attached thereto, and the February 24 and April 21 memoranda be entered specifically recognizing the validity of appellant's security interest in the accounts receivable and the proceeds in accordance with his secured claim filed in the bankruptcy proceedings.

Respectfully submitted,

Gilbert Sussman,
Sussman, Shank & Wapnick
Attorneys for Appellant,
Robert J. Davis

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this biref, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Gilbert Sussman
Sussman, Shank & Wapnick

APPENDIX

DAVIS DECEMBER 13, 1963 AGREEMENT

"AGREEMENT

THIS AGREEMENT is duly executed and made and entered into by and between Portland Reporter Publishing Comany, Inc. (herein called Assignor) and Robert J. Davis (herein called Assignee) at Portland, Oregon, this 13th day of December, 1963.

WHEREAS, Assignor desires to assign to Assignee accounts receivable which are unpaid but which are due and owing or which will become due for advertising services rendered by Assignor, and

WHEREAS, it is the desire of the parties that said assignments be security to the Assignee for his contingent liability upon a Collateral Agreement executed the 13th day of December, 1963, between Assignor and the First National Bank of Oregon.

NOW, THEREFORE, the parties agree as follows:

1. The Assignee will from time to time, during the continuance of this agreement, select such accounts receivable as shall total not less than \$35,000 nor more than \$40,000 at any one time. In the event that the total amount of the accounts at any time exceeds \$40,000, then there shall be a prorata deduction from the accounts so that the total is not more than \$40,000.

2. Concurrently with such selection the As-

signor will, by proper instrument in writing, a form of which is attached hereto, unconditionally assign, transfer and set over to the Assignee, his successors and assigns, all of Assignor's rights, title and interest in said accounts.

3. Assignor shall furnish Assignee a statement of its accounts receivable upon request and shall permit Assignee to have access to its books and records disclosing the accounts.

4. In order to avoid objections by, and any possible loss of trade from, any of Assignor's customers, through the collection of said accounts by the Assignee direct from the debtors, it is agreed that the Assignee gives to Assignor the privilege to collect said accounts as the Assignee's agent. Upon such collection, Assignor shall, providing it is in default as defined in paragraph 7, forthwith turn over the proceeds to Assignee and Assignee shall have the full right to deposit the debtor's checks and remittances in his own bank accounts. This agency for collection may be terminated by the Assignee at any time.

5. If any such account cannot be collected within a reasonable time and after reasonable efforts, Assignor will accept a reassignment of said accounts and Assignee may thereupon select another account to be assigned.

6. Upon such assignment, Assignor agrees forthwith to make proper entries on its books and records disclosing the assignment.

7. Any such assignment is for the sole purpose of providing security to Assignee upon his obligation under the agreement heretofore re-

ferred to and it is agreed that so long as Assignor is not in default Assignee shall not be entitled to the proceeds from any account periodically collected but the same shall remain the sole property of the Assignor. Assignor shall be deemed to be in default when Assignor is declared to be bankrupt, is in default on the agreement of December 13, 1963, voluntarily terminates its business, assets or stock.

WITNESS our hands and seals the day and year first above written.

PORTLAND REPORTER PUBLISHING COMPANY, INC.
BY: /s/ ROBERT D. WEBB
Assignor
/s/ ROBERT J. DAVIS
Robert J. Davis"

DECEMBER 13, 1963 ASSIGNMENT

"ASSIGNMENT

Portland Reporter Publishing Company, Inc. herein called Assignor) for valuable consideration, hereby transfers, assigns and sets over to Robert J. Davis, his successors and assigns, all of the right, title and interest of the Assignor in and to the following accounts:

SCHEDULE A

Robert J. Davis Assignment of Accounts Receivable

The following accounts receivable taken as of November 30, 1963, these accounts are marked NOV 30 1963 RJD

[Here appears names of accounts, balances as of November 30, 1963, and paying habits, that is '10 to 60 days,' 'slow,' 'unknown.']

	27,162.49
Circulation accounts receivable to total	7,837.51
	35,000.00

This assignment shall be upon the terms and conditions of the Agreement entered into by and between the parties the 13th day of December, 1963.

PORTLAND REPORTER PUBLISHING COMPANY, INC.
BY: /s/ ROBERT D. WEBB

I hereby appoint Portland Reporter Publishing Company, Inc. through its duly authorized representative as my agent to collect said accounts and disburse the same in accordance with the Agreement of the parties made and entered into the 13th day of December, 1963.

/s/ Robert J. Davis
Robert J. Davis"

FEBRUARY 21 MEMORANDUM

"MEMO TO: BOARD OF DIRECTORS OF PORTLAND REPORTER PUBLISHING CO., INC., DON S. WILLNER, ROBERT A. BENNETT, AND ROBERT J. DAVIS

FROM: KEITH W. PLOTNER, CONTROLLER
RE: ACCOUNTS RECEIVABLE ASSIGNMENT TO ROBERT J. DAVIS

The following lists of accounts receivable taken as of February 24, 1964 is to show the current standing of the original assignment of these accounts November 30, 1963 and February 24, 1964 RJD.

ACCOUNT NAME	AMOUNT AS OF FEB. 24, 1964	PAYING HABITS

[Here appear names of accounts, balances, as of February 24, 1964, and paying habits, that is '15 to 90 days', 'slow'.]

ADDITIONAL CLASSIFIED ASSIGNED AS OF FEBRUARY 24, 1964

[Here appears names of accounts, balances as of February 24, 1964, and paying habits that is '15 to 90 days', 'slow.']

ADDITIONAL DISPLAY ASSIGNED AS OF FEBRUARY 24, 1964

[Here appears names of accounts, balances as of February 24, 1964, and paying habits that is '15 to 90 days', 'slow'.]

$18,309.81

ALL CIRCULATION ACCOUNTS RECEIVABLE ARE HEREBY ASSIGNED IN THE AMOUNT OF $16,690.19

TOTAL $35,000.00"

APRIL 21 MEMORANDUM

"April 21, 1964

MEMO TO: THE BOARD OF DIRECTORS OF THE PORTLAND NEWSPAPER PUBLISHING CO., INC., WALTER EVANS, DON S. WILLNER, ROBERT A. BENNETT, AND ROBERT J. DAVIS

FROM: KEITH W. PLOTNER, CONTROLLER

RE: ACCOUNTS RECEIVABLE ASSIGNMENT TO ROBERT J. DAVIS

The following list of accounts receivable taken as of April 21, 1964 is to show the current standing of the original assignment of these accounts November 30, 1963 and February 24, 1964 RJD.

ACCOUNT NAME	AMOUNT AS OF APRIL 21, 1964

[Here appear names of accounts and balances as of April 21, 1964]

CIRCULATION A/R	$18,752.56
	35,183.75"

SUBORDINATION AGREEMENT

"AGREEMENT

This agreement is made this 13th day of December 1963, between PORTLAND REPORTER PUBLISHING COMPANY, INC., (hereinafter called Reporter) and ROSE CITY DEVELOPMENT COMPANY, INC., (hereinafter called Rose City).

The Accounts Receivable Loan and Security Agreement between the parties dated November 22, 1963, is hereby modified so as to provide that the agreement of this date between Reporter Robert J. Davis and the assignment of accounts receivable which may take place from time to time in accordance with the provisions of that agreement shall take precedence over the agreement of November 22, 1963, between these partis.

PORTLAND REPORTER PUBLISHING COMPANY, INC.
By s/ ROBERT D. WOBB, President
ROSE CITY DEVELOPMENT COMPANY, INC.
By s/ ASA T. WILLIAMS, SR.

Relevant sections of the Uniform Commercial Code relating to the first issue.

§ 1-102 (ORS 71.1020)

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

§ 1-201 (ORS 71.2010)

(3) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205 and 2-208).

(39) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

The official comment thereon is as follows:

(3) "Agreement." New. As used in this Act the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of this Act to displace a stated rule of law.

(39) "Signed." New. The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentica-

tion may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

§ 1-205 (ORS 71.2050)

(1) This Act rejects both the "lay-dictionary" vious conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(3) A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

The official comment thereon contains the following:

1. This act rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. Course of dealing under subsection (1) is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning. (Section 2-208.)

3. "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

§ 2-208 (ORS 72.2080)

(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1-205).

(3) Subject to the provisions of the next section on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

The official comment thereon contains the following:

> 1. The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the "agreement" and therefore also of the "unless otherwise agreed" qualification to various provisions of this Article.
>
> 2. Under this section a course of performance is always relevant to determine the meaning of the agreement. Express mention of course of performance elsewhere in this Article carries no contrary implication when there is a failure to refer to it in other sections.
>
> 3. Where it is difficult to determine whether a particular act merely sheds light on the meaning of the agreement or represents a waiver of a term of the agreement, the preference is in favor of "waiver" whenever such construction, plus the application of the provisions on the reinstatement of rights waived (see Section 2-209), is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship.

It is recognized that UCC § 2-208 is in the article relating to sales. However, there is nothing in UCC § 1-201(3) referring to this section that indicates the word "Agreement" therein defined means only sales contracts and not security agreements as well, and it would seem that these observations have equal application and should equally be applied to a document which constitutes a security agreement. This was in

fact done in In re Bengston, 3 UCC Rep. 283 (D.C., Conn., Ref. Op. 1965) in which a conditional sales contract constituted the security agreement but failed to comply with certain technical requirements. The Court made reference to the definition of agreement as set forth in the Code and quoted the Official Comment on UCC § 1-205 dealing with "Course of Dealing and Usage of Trade." It also set forth UCC § 2-208 and the Official Comment thereon, and observed that:

> "the parties unquestionably understood the terms of the agreement which at the time of bankruptcy had been in effect for approximately two years during which time there was no apparent difficulty between the parties in interpreting their agreement."

The Court then said, at p. 291:

> "Applying these criteria it is abundantly clear that the parties understood the agreement they made, they conducted themselves without objection under the agreement for a long period of time and a *'liberal construction of the act' applied to promote its underlying purposes and policies dictates that the security agreement be found valid as against the trustee.*" (Emphasis supplied)

§ 9-110 (ORS 79.1100)

> For the purposes of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

The official comment thereon reads as follows:

The requirement of description of collateral (See Section 9-203 and Comment thereto) is evidentiary. The test of sufficiency of a description laid down by this Section is that the description do the job assigned to it—that it make possible the identification of the thing described. Under this rule courts should refuse to follow the holdings, often found in the older chattel mortgage cases, that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called "serial number" test. The same test of reasonable identification applies where a description of real estate is required in a financing statement. See Section 9-402.

§ 9-203 (ORS 79.2030)

(1) Subject to the provisions of Section 4-208 on the security interest of a collecting bank and Section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties unless

(b) the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.

The official comment thereon reads in part as follows:

1. Here as elsewhere in this Article, following the policy of the Uniform Trust Receipts Act, formal requisites are reduced to a minimum. The

technical requirements of acknowledgment, accompanying affidavits, etc., common to much chattel mortgage legislation, are abandoned. The only requirements for the enforceability of nonpossessory security interests in cases not involving land are (a) a writing; (b) the debtor's signature; and (c) a description of the collateral or kinds of collateral.

3. One purpose of the formal requisites stated in subsection (1) (b) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured.

5. The formal requisites stated in this Section are not only conditions to the enforceability of a security interest against third parties. They are in the nature of a Statute of Frauds. Unless the secured party is in possession of the collateral, his security interest, absent a writing which satisfies subsection (1) (b), is not enforceable even against the debtor, and cannot be made so on any theory of equitable mortgage or the like. If he has advanced money, he is of course a creditor and, like any creditor, is entitled after judgment to appropriate process to enforce his claim against his debtor's assets; he will not, however, have against his debtor the rights given a secured party by Part 5 of this Article on Default. The theory of equitable mortgage, insofar as it has operated to allow creditors to enforce informal security agreements against debtors, may well have developed as a necessary escape from the elaborate requirements of execution, acknowledgment and the like which the nineteenth cen-

tury chattel mortgage acts vainly relied on as a deterrent to fraud. Since this Article reduces formal requisites to a minimum, the doctrine is no longer necessary or useful. More harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing.

§ 9-402 (ORS 79.4020)

1. A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral.

5. A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

The official comment thereon contains the following:

1. Subsection (1) sets out the simple formal requisites of a financing statement under this Article. These requirements are: (1) signatures and addresses of both parties; (2) a description of the collateral by type or item.

2. This Section adopts the system of "notice filing" which has proved successful under the Uniform Trust Receipts Act. What is required to be filed is not, as under chattel mortgage and conditional sales acts, the security agreement itself, but only a simple notice which may be filed

before the security interest attaches or thereafter. The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs.

5. Subsection (5) is in line with the policy of this Article to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of such statutory requirements in which courts have occasionally indulged themselves.

Relevant sections of the Bankruptcy Act and the Uniform Commercial Code relating to the second issue.

The Bankruptcy Act

§ 60a (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or again him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee. If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

§ 60b Any such preference may be avoided

by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property, or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: *Provided, however,* That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee. For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction.

§ 9-108 (ORS 79.1080)

Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property, his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such

collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

Thes Official Comment thereon is in part as follows:

1. Many financing transactions contemplate that the collateral will include both the debtor's existing assets and also assets thereafter acquired by him in the operation of his business. This Article generally validates such after-acquired property interests (see Section 9-204 and Comment) although they may be subordinated to later purchase money interests under Section 9-312(3) and (4).

Interests in after-acquired property have never been considered as involving transfers of property for antecedent debt merely because of the after-acquired feature, nor should they be so considered. The section makes explicit what has been true under the case law: an after-acquired property interest is not, by virtue of that fact alone, security for a pre-existing claim. This rule is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable as preferences. The determination of when a transfer is for antecedent debt is largely left by the Bankruptcy Act to state law.

Two tests must be met under this section for an interest in after-acquired property to be one not taken for an antecedent debt. *First*: the secured party must, at the inception of the transaction, have given new value in some form. *Second*: the after-acquired property must come in

either in the ordinary course of the debtor's business or as an acquisition which is made under a contract of purchase entered into within a reasonable time after the giving of new value and pursuant to the security agreement.

§ 9-204 (ORS 79.2040)

(1) A security interest cannot attach until there is agreement (subsection (3) of Section 1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

(2) For the purposes of this section the debtor has no rights * * *

(d) in an account until it comes into existence.

(3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.

The Official Comment thereon is in part as follows:

1. Subsection (1) states three basic prerequisites to the existence of a security interest: agreement, value and collateral. When these three coexist a security interest may, in the terminology adopted in this Article, attach. Perfection of a security interest will in many cases depend on the additional step of filing a financing statement (see Section 9-302); Section 9-301 states who will take priority over a security interest which has attached but which has not been perfected. The second sentence of the subsection states a

rule of construction under which the security interest, unless postponed by explicit agreement, attaches automatically when the three stated events have occurred.

2. Subsections (1) and (3) read together make clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. (To this general rule subsection (4) states two exceptions.) That is to say: the security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party—such as the taking of a supplemental agreement covering the new collateral — is required. This does not however mean that the interest is proof against subordination or defeat: Section 9-108 should be consulted on when a security interest in after-acquired collateral is not security for antecedent debt, and Section 9-312 (3) and (4) on when such a security interest may be subordinated to a conflicting purchase money security interest in the same collateral.

§ 9-205 (ORS 79.2050)

A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts, contract rights or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to

require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

The Official Comment thereon is in part as follows:

1. This Article expressly validates the floating charge or lien on a shifting stock. (See Sections 9-201, 9-204, and Comment to Section 9-204). This section provides that a security interest is not invalid or fraudulent by reason of liberty in the debtor to dispose of the collateral without being required to account for proceeds or substitute new collateral. It repeals the rule of Benedict v. Ratner, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 991 (1925), and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral. The principal effect of the Benedict rule has been, not to discourage or eliminate security transactions in inventory and accounts receivable — on the contrary such transactions have vastly increased in volume —but rather to force financing arrangements in this field toward a self-liquidating basis.

§ 9-303 (ORS 79.3030)

1. A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

The Official Comment thereon is as follows:

1. The term "attach" is used in this Article to describe the point at which property becomes subject to a security interest. The requisites for attachment are stated in Section 9-204. When it attaches a security interest may be either perfected or unperfected: "Perfected" means that the secured party has taken all the steps required by this Article as specified in the several sections listed in subsection (1). A perfected security interest may still be or become subordinate to other interests (see Section 9-312) but in general after perfection the secured party is protected against creditors and transferees of the debtor and in particular against any representative of creditors in insolvency proceedings instituted by or against the debtor. Subsection (1) states the truism that the time of perfection is when the security interest has attached and any necessary steps for perfection (such as taking possession or filing) have been taken. If the steps for perfection have been taken in advance (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral), then the interest is perfected automatically when it attaches.

INDEX OF EXHIBITS

Exhibit Number	Marked	Received
DuBay & Rose City Ex. No. 33	402	402
Davis Exhibit No. 34	416	417
Trustee's Exhibit No. 35	421	422
Trustee's Exhibit No. 36	422	422
Trustee's Exhibit No. 37	423	423
Trustee's Exhibit No. 38	423	423
DuBay & Rose City Ex. No. 39	Received by order on stipulation	
Davis Exhibit No. 40	Received by order on stipulation	

No. 22597

United States

COURT OF APPEALS

for the Ninth Circuit

n the Matter of

PORTLAND NEWSPAPER PUBLISHING
COMPANY, INC.,

Bankrupt,

R. ANTHONY DUBAY,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in
Bankruptcy of PORTLAND NEWSPAPER
PUBLISHING COMPANY, INC.,

Appellee.

BRIEF OF APPELLEE, EVERETTE H. WILLIAMS

*On Appeal from the United States District Court
for the District of Oregon*

BOYRIE, MILLER AND LONG and
QUITTNER, STUTMAN, TRIESTER AND GLATT,
BOYD J. LONG,
480 Pittock Block, Portland, Oregon 97205,
Attorneys for Appellee Everette H. Williams.

STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 7-68

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No. 22507

United States
COURT OF APPEALS
for the Ninth Circuit

In the Matter of

PORTLAND NEWSPAPER PUBLISHING COMPANY, INC.,

Bankrupt,

R. ANTHONY DUBAY,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of PORTLAND NEWSPAPER PUBLISHING COMPANY, INC.,

Appellee.

BRIEF OF APPELLEE, EVERETTE H. WILLIAMS

On Appeal from the United States District Court for the District of Oregon

JURISDICTION

Appellant filed a claim in the within proceedings claiming a secured interest in certain of the bankrupt's accounts receivable. The claim was disallowed by order of the Referee, which order was affirmed by the United States District Court.

The jurisdiction of this court is based upon an appeal from the order affirming the order of the Referee under Section 24(a) of the Bankruptcy Act, 11 U.S.C. § 47a.

STATEMENT OF THE CASE

While some background circumstances and admitted facts against which the issues may be projected may assist in a consideration of the issues, it is submitted that the recitation of those facts and circumstances contained in the opinion of the Referee and District Judge are adequate in this regard and do not need to be repeated. It is also submitted that the "Statement of the Case" and "Statement of Facts" of appellant should be read with caution since they contain facts which not only cloud the issues herein, but, in addition, assume as facts the very essence of the controversy herein. The pertinent facts necessary to decide the legal issues herein are as follows:

In July of 1962, the bankrupt's predecessor, Portland Reporter Publishing Company, Inc., and appellant entered into an agreement (Ex. 16) which provided for the assignment from time to time of certain accounts.

The pertinent provisions of the agreement are:

> "WHEREAS, Assignor desires to assign to Assignee accounts receivable which are unpaid but which are due and owing or which will become due for advertising services rendered by Assignor . . . .

"1. The Assignee will from time to time, during the continuance of this agreement, select such accounts receivable as shall total not more than $40,000 at any one time . . . .

"2. Concurrently with such selection the Assignor will, by proper instrument in writing, a form of which is attached hereto, unconditionally assign, transfer and set over to the Assignee, his successors and assigns, all of Assignor's rights, title and interest in said accounts . . . .

"5. If any such account cannot be collected within a reasonable time and after reasonable efforts, Assignor will accept a reassignment of said account and Assignee may thereupon select another account to be assigned."

Attached to the agreement was an executed as-ignment of certain advertising accounts, being 62 in umber.

The Uniform Commercial Code went into effect in)regon on the 1st day of September, 1963. A financ-ng statement which noted a security interest in favor f appellant in accounts receivable of Portland Re-orter Publishing Company was filed. No financing tatement was ever filed showing the bankrupt as lebtor.

From time to time, and under dates of August 31, 962, April 30, 1963, November 30, 1963, February 4, 1964 and April 21, 1964, Memorandum lists con-aining therein certain accounts receivable and mounts due thereon, which such lists appellant

claims to be assignments of those accounts receivable, were delivered to appellant. The list of April 21, 1964 contained the names of only 14 of the 62 accounts included in the assignment of July 31, 1962.

On October 15, 1964, and after almost all of the accounts referred to on the Memorandum list of April 21, 1964, were collected, Portland Newspaper Publishing Company, Inc., successor corporation to Portland Reporter Publishing Company, filed bankruptcy. Appellant filed a "claim of secured creditor" (Ex. 15) asserting an interest in the current balances due on the accounts referred to and described in the list of April 21, 1964.

The Trustee filed an objection to the claim of appellant as a secured creditor, which such claim was disallowed by the Referee.

ANSWER TO SPECIFICATION OF ERROR NO. 1

Appellant did not have a lien on future balances in any particular account or accounts, or in future accounts, by reason of the agreement of July 31, 1962, or otherwise.

It is argued by appellant that the intention of the parties is clear. DuBay was to have a security interest in future accounts. To support said contention he recites in his statement of facts certain portions of the agreement of July 31, 1962. He omits therefrom paragraphs (2) and (5) which contain pertinent provisions. Those provisions and the entire agreement

are inconsistent with the transfer of accounts not yet in existence.

In further support of appellant's argument that the intention of the parties was clear, various portions of the testimony of the Controller are set forth. There was no testimony indicating, however, that the intention of Plotner was the intention of the corporation.

The agreement provided that appellant would "from time to time" select "accounts totaling $40,000.00," (later reduced to $35,000.00) and that, if appellant was unable to collect an account which had been assigned to him, he would reassign the account and select another account. The agreement also provided that when an account was selected it would be reassigned by a "proper instrument in writing," the form of which was attached to the agreement. Subsequently, and under dates of August 31, 1962, April 30, 1963, November 30, 1963, February 24, 1964, and April 21, 1964, lists of accounts in the form of memoranda were prepared. There appeared on the list of April 21, 1964, only 14 names that appeared in the list of 62 accounts named in the assignment of July 31, 1962. Accordingly, the list of April 21, 1962, was not a statement of current standing of accounts assigned on July 13, 1962, but could only have effect, if construed as a new assignment of accounts. Trustee contends that the provisions of the original agreement and all of the acts subsequent thereto, are inconsistent with the transfer of accounts not yet in existence

and negate the suggestion that there was an assignment of future accounts.

Even if the memorandum list of April 21, 1964, is considered as an assignment, it does not make reference to any future accounts. The list specifically names advertisers with specific amounts due at a particular time. Specific advertisers and amounts then due from them would not have been listed if the parties intended to assign future accounts.

The assignment of an "account" does not in and of itself include the assignment of after acquired or future balances in the account. To assign accounts which arise in the future, one must assign "future accounts" since by its very definition "account" is limited to moneys already due. UCC § 9-106(1) (ORS 79.1060(1)).

Because of a modification to U.C.C. § 9-106 in Oregon, appellant argues that in Oregon "account" may and can mean "future accounts." Trustee submits that the modified section, ORS 79.1060, has been misinterpreted. That statute reads:

> "In ORS 79.1010 to 79.5070, *unless the context otherwise requires*:
>
> (1) "Account means *any right to payment* for goods sold for services rendered . . .
>
> (2) "Contract right" means any right to payment under a contract *not yet earned* by performance . . . (Emphasis added).

A clear reading of the statute reveals that it is

not the context of the security agreement, but the *context* of Article 9 which the statute refers to.

If "account" were to mean "future" or "after acquired accounts" and "inventory" were to mean "future or acquired" inventory without the security agreement so specifically providing, the purpose of UCC § 9-204 (ORS 79.2040) would be rendered meaningless. *In re Taylored Products, Inc.*, 5 UCC Rep. 286, (D.C. W.D. Mich. Ref. op. 1968).

Appellant suggests that, as was allegedly done in *In re Bengston*, 3 UCC Rep. 283 (D.C. Conn. Ref. op. 1965), this court should construct an agreement as the parties "intended." *In re Bengston* is not authority for such. It did not even concern itself with Article 9 of the UCC, but dealt with the Connecticut Retail Installment Sales Financing Act. That act required the number of payments and the amount and date of each payment to be set out. Appropriate blanks did not contain the date of the starting payment, which the court held was unquestionably understood by the parties. It can hardly be said that those facts created a problem similar to the one presented here.

The DuBay agreement clearly did not include "future accounts." Inadvertent testimony by the Controller that "account" means "future account" is no reason to ask this court to redraw the agreement inconsistent with the terms thereof.

DuBay asserts that it is clear what the parties intended. All demonstrative evidence indicates that they did not intend to assign "future accounts." The min-

imum requirements necessary to create a security interest in "future accounts" were not fulfilled. That the parties may have intended to assign "future accounts" can avail appellant nothing if they did not in fact do so.

ANSWER TO SPECIFICATION OF ERROR NO. 2

Appellant contends first that the court erred in holding that the later DuBay assignments "did not even contain words of assignment or the signature of the debtor."

1. The question presented by the first portion of appellant's specification of error is whether or not a memorandum list of April 21, 1964, by itself is a "security agreement" within the intent and meaning of the Uniform Commercial Code. The contents of other lists which were supplied between the original agreement of July 31, 1962, and the list of April 21, 1964, are ignored since it is only the April 21, 1964, list upon which appellant relies (Ex. 15).

Appellant asserts that the Referee and District Judge are requiring "magic words" and that a clear reading of the memorandum read together with other agreements and coupled with the testimony of the controller produce a "security agreement." It is not, however, the lack of "magic words" that renders the memorandum list of April 21, 1964, ineffective but the lack of any words whatsoever which can be construed as an immediate transfer or assignment of accounts

or to impart a security interest therein. The memorandum does not by itself purport to create such an interest.

The pertinent provisions of the Uniform Commercial Code as adopted in Oregon and in question herein are as follows:

ORS 79.2030 (UCC § 9-203)

"(1) Subject to the provision of ORS 74.2080 on the security interest of a collecting bank and ORS 79.1130 on a security interest arising under ORS 72.1010 to 72.7250 on sales, a security interest is not enforceable against the debtor or third parties unless;

(a) The collateral is in the possession of the secured party; or

(b) The debtor has *signed a security agreement* which contains a description of the collateral and in addition . . . ." (Emphasis added)

ORS 79.1050

"(1) In ORS 79.1010 to 79.5070 unless the context otherwise requires:

(h) Security agreement 'means an *agreement* which *creates* or *provides for a security interest.*'" (Emphasis added)

The above provisions are relatively simple. Magic words, acknowledgments, affidavits and the like are no longer necessary in modern commercial financing. All that is necessary is a written and *signed agreement* which "creates or provides for a security interest."

In the case of *American Card Company* v. *H.M.H. Co.*, 196 A.2d 150, 97 R.I. 59 (1963), a similar argument was made in contending that a financing statement signed by a debtor was a sufficient security agreement since it contained words and phrases such as "secured party," and "collateral." In that case, like here, appellant argued that "magic words" were unnecessary, that "under the unique circumstances that exist" the minimum requirements of UCC § 9-203 were satisfied, and that whether or not a security interest is "created or provided for," is a question of fact which must be decided upon the basis of the words and deeds of the parties. The court rejected the argument and held that *words of grant* were necessary and that words and deeds were insufficient to supply the absence of a required security agreement in writing.

In a recent case, *In re Fernandes Welding & Equipment Service, Inc.,-Safe Deposit Bank & Trust Co.* v. *Berman*, 5 UCC Rep. 1, — F.2d — (1 Cir., April 22, 1968) the debtor signed a promissory note which on its face stated:

> "*Security interest* in accounts receivable, contract rights etc. under *agreement* dated 6/26/53; Also equipment etc. under *security agreements* dated 7/30/63." (Emphasis added).

The court held that the note, even though reciting data relating to collateral security was not thereby converted into such an agreement.

In a similar case, the debtor signed a note stating thereon:

> "There have been *deposited* herewith as *collateral security* the following: '1963 Ford Falcon . . . .' " (Emphasis added).

The court held:

> "The recitation in the promissory note that the motor vehicle had been 'deposited' with the bank as collateral security falls far short of constituting even an inartful grant of a security interest." *In re Vielleux*, 5 UCC Rep. 277, 278 (D. Conn. Ref. op. 1967).

In re Excel Stores, Inc., 341 F.2d 961 (2 Cir. 1964) cited by appellant in this regard is not in point since it deals solely with the sufficiency of a financing statement.

Appellant argues (footnote, page 21 of brief) that if the formal requirements were not met in the memorandum lists, the agreement of July 31, 1962 should be revived to give DuBay an interest in the accounts listed therein. Appellant ignores the finding by a Referee that the agreement of July 31, 1962 was invalid as against the Trustee. Anticipating the argument that the filing of a financing statement revitalized and perfected the security interest created in the agreement, Trustee submits that the law is clear that a pre-Code agreement, void as to creditors, is not given life after the advent of the Code by the mere filing of a financing statement. In *Scott* v. *Stocker*, 380 F.2d 123 (10 Cir. 1967) the court specifically held that a security agreement entered into before the Uniform Commercial Code and at that time in-

valid as against creditors but valid under the code, was not validated by the code even though a financing statement was filed. In that case it was also argued that the financing statement was sufficient to constitute a security agreement. The court replied:

> "We see no merit in the appellants final argument that the financing statement filed on January 18, 1963, was sufficient also as a security agreement. Nowhere in the form is there an evidence of an *agreement by the debtor to grant to lender an interest* in the collateral." (Emphasis added) (Supra at p. 127)

The court, in the case of *Mid-Eastern Electronics, Inc.* v. *First Nat'l Bank of So. Md.*, 380 F.2d 355 (4 Cir. 1967) struck down an alleged security interest because of a lack of a signed agreement "giving even sketchily, the terms of the security agreement . . . ." (p. 356)

2. The second question presented by appellants specification of error No. 2 is whether or not a security agreement must be "signed" by the debtor or contain the debtor's signature.

It is only necessary to read the official comment to the Code to see that UCC § 9-203 (ORS 79.2030) is in the nature of a statute of frauds. Official comment 5 states in part:

> "The formal requisites stated in this section are not only conditions to enforceability for a security interest against third parties. They are in the nature of a *statute of frauds* * * * *. More harm than good would result from allowing cred-

> itors to establish a secured status *by parol evidence* after they have neglected the simple formality of obtaining a *signed writing*." (Emphasis added)

In the *Mid-Eastern Electronics* case (supra) the court in referring to UCC § 9-203 stated at page 356:

> "A security interest, additionally, is unenforceable unless, under the Codes' statute of frauds, the debtor has signed a security agreement . . . 'agreement' means the *bargain of the parties* in fact . . . ." (Emphasis added)

The list of April 21, 1964 is not only unsigned, but is far from containing the bargain of the parties. No terms of any kind exist therein.

Appellant argues that the memorandum lists are "signed" because Keith Plotner, Controller, testified that he typed his name. Nowhere is there testimony that the Controller intended his "typing" to be the signature of the debtor, nor did he testify that by so typing his name he intended to "create or provide" for a security interest in favor of DuBay. It is submitted that there is no testimony that Plotner intended his typing "to authenticate" a security agreement under the meaning of UCC § 1-201 (ORS 71.2010 (30)).

The case of *Plemens* v. *Didde-Glaser, Inc.*, 224 A.2d 464, 244 Md. 556 (1966) cited by appellant deals with only the signature of the debtor on a financing statement. The court held that an individual's signature without a representation of capacity was

sufficient on a financing statement although it *might not be so as to a security agreement.*

Benedict v. *Lebowitz*, 346 F.2d 120 (2 Cir. 1965) deals not only with a financing statement but also with a signature of the creditor rather than that of the debtor. It is submitted that the above cases do not support appellant's contention.

APPELLANT'S SECURED CLAIM IS INVALID FOR OTHER REASONS THAN RECITED ABOVE

Appellant has asserted on this appeal only two propositions, the first that the assignments gave to him a lien on future accounts, and, secondly, that the memorandum list of April 21, 1964 was a valid assignment and did grant to him a security interest in the accounts listed therein. Appellant's claim fails, however, on numerous other grounds not referred to in his brief, as follows:

1. Because of the unfettered dominion and control over the accounts and their proceeds by the debtor, the agreement of July 31, 1962 was fraudulent in law. *Benedict* v. *Ratner*, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 2d 991 (1925). The mere filing of a financing statement after the effective date of the Code was ineffectual to validate that agreement. *Scott* v. *Stocker*, 380 F.2d 123 (10 Cir. 1967).

2. Even if the agreement of July 31, 1962 included "future accounts" and the filing of the financing statement perfected the interest as to those accounts,

it would be void as to creditors existing at the time, and, therefore, as to the Trustee. (Ref's. op. p. 25).

3. The agreement of July 31, 1962, and, therefore, any assignments in accordance therewith, specifically provides that until default, the debtor remains the *sole owner* of the accounts. Such an agreement would seem to explicitly postpone perfection of DuBay's alleged security interest as provided for in UCC § 9-204. The perfection of the security interest on the 28th of September, 1964, by the declaration of default (Ref. op. p. 26) would, under the circumstances existing at the time, clearly be preferential.

4. Any security interest which DuBay may have had in any accounts of the bankrupt was not valid against the Trustee under UCC § 9-301(1) because it was unperfected. In order for a security agreement to be perfected, a financing statement must be filed. (UCC § 9-302). A financing statement must be signed by the debtor. (UCC § 9-402). No financing statement even listing the bankrupt as debtor was filed by DuBay. By reference, Trustee incorporates herein the argument contained on pages 17-20 of the brief of Everette H. Williams, Appellant, v. Rose City Development Company, Inc., Appellee, filed herein.

5. Assuming for the sake of argument that the DuBay assignments are valid as security agreements and grant a security interest in "future accounts" and otherwise survive the objections heretofore made, Trustee contends that as to those accounts which came into existence within the four months immediately

preceding the commencement of the within proceedings, DuBay would benefit by a preferential transfer voidable for the same reasons set forth by the Referee as to the claims of Rose City Development Company, Inc. Trustee incorporates by reference the brief of appellant, Everette H. Williams filed herein as it applies to the claim of Rose City Development Company, Inc., Appellee.

CONCLUSION

Appellant does not have a valid security interest in any of the accounts of the bankrupt. To hold otherwise would be to ignore the bare essential requirements and formalities which the Code requires. For the foregoing reasons, the order below, to the extent it affirmed the order of the Referee as to the alleged security interest of R. Anthony DuBay, should be affirmed.

Respectfully submitted,

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BOYD J. LONG
Attorneys for Appellee,
Trustee in Bankruptcy

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation f this brief, I have examined Rules 18, 19 and 39 of ne United States Court of Appeals for the Ninth Cir-uit, and that, in my opinion, the foregoing brief is 1 full compliance with those rules.

Boyd J. Long
Attorney for Appellee,
Everette H. Williams

No. 22507-A

United States
COURT OF APPEALS
for the Ninth Circuit

In the Matter of Portland Newspaper Publishing Company, Inc., Bankrupt,

EVERETTE H. WILLIAMS,

Appellant,

v.

ROSE CITY DEVELOPMENT COMPANY, INC.,

Appellee.

BRIEF OF APPELLEE

On Appeal from the United States District Court for the District of Oregon

FILED

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No. 22507-A

United States
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EVERETTE H. WILLIAMS,

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ROSE CITY DEVELOPMENT COMPANY, INC.,

Appellee.

BRIEF OF APPELLEE

On Appeal from the United States District Court for the District of Oregon

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

A. Issues not properly before this court.

1. May the trustee raise in this court for the first time the contention that a new financing statement and security agreement had to be signed and filed after the corporate merger of Portland Reporter Publishing Company, Inc. and Portland Newspaper

Publishing Company, Inc., when this issue was not raised before the referee or before the District Court?

2. May the trustee raise in this court the contention that the trustee may subrogate to any subordination rights of Davis against Rose City when Davis' subordination rights were denied by the District Court in its final order and excluded by the trustee in his notice of appeal?

B. Issues properly before this court.

1. Was the District Court correct in holding that the bankrupt did not give a voidable preference to Rose City, the secured creditor, when the level of assigned accounts receivable remained approximately constant during the four months before the bankruptcy and always exceeded the amount of the debt?

2. Was the District Court correct in holding that the "floating lien" section of the Oregon Uniform Commercial Code (which is identical with the law of the District of Columbia and every state except Louisiana) is valid?

STATEMENT OF THE CASE

This controversy arises from a proceeding in bankruptcy in which the trustee in bankruptcy filed a petition seeking to have Rose City Development Company, Inc., (hereinafter called "Rose City") and others pay over to the bankruptcy estate the proceeds of certain of the bankrupt's accounts receivable. The

referee ignored the level of assigned accounts receivable and held that the "floating lien" section of the Uniform Commercial Code violates federal law. The District Judge reversed the referee holding that Rose City was not given a voidable preference and upheld the "floating lien" section of the Uniform Commercial Code. The trustee has appealed and the jurisdiction of this court is based upon an appeal from the final order below pursuant to 11 U.S.C. § 47(a).

The following chronology may be helpful in understanding this case.

1. February 8, 1960—Portland Reporter Publishing Company, Inc. incorporates and begins publication of the "Portland Reporter," a weekly and later daily newspaper in Portland, Oregon (Ex. 2).

2. November 16, 1963—Rose City loans Reporter $45,000, consolidating previous loans (Ex. 17, Tr. p. 137).

3. November 22, 1963—Rose City loans Reporter additional $10,300 and the parties enter into an "Accounts Receivable Loan and Security Agreement" covering all loans and assigning "all accounts receivable of the debtor now existing or hereafter arising (herein called 'accounts')" (except those actually assigned to DuBay, and, by later modification, also except those actually assigned to Davis) (Tr. p. 237; Ex. 17).

4. November 26, 1963—Financing statement filed showing that accounts receivable had been assigned (Ex. 3).

5. February 27, 1964 to March 4, 1964—Rose City and two other secured creditors collect accounts receivable directly from debtors (Ex. 39).

5.A. April 22, 1964—Portland Reporter Publishing Company, Inc. merges into Portland Newspaper Publishing Company, Inc. which continues to publish the "Portland Reporter" (Ex. 11).

6. September 28, 1964—Rose City and other secured creditor start to collect all accounts receivable directly from debtors (Ex. 36).

7. October 15, 1964—Bankruptcy petition filed (Tr. of R. p. 129).

8. December 15, 1964—Trustee in Bankruptcy files petition to have Rose City and other secured creditors pay over proceeds of assigned accounts (Tr. of R. p. 130).

9. May 25, 26, 27 and June 10, 1965—Referee conducts trial (Tr. of R. p. 131).

10. February 9, 1966—Referee rejects Rose City's secured claim (Tr. of R. p. 1).

11. March 11, 1966—Rose City files petition for review (Tr. of R. p. 131).

12. January 27, 1966—District Court hears arguments (Tr. of R. p. 135).

13. August 22, 1967—District Court opinion reverses Referee and sustains validity of Rose City secured claim (Tr. of R. p. 89).

14. November 7, 1967—District Court opinion denies contention that Davis entitled to payment from accounts assigned to Rose City (Tr. of R. p. 114).

15. November 7, 1967—District Court enters final order (Tr. of R. p. 136).

16. December 5, 1967—Trustee files notice of appeal from that portion of final order "reversing the order of the Referee disallowing the claim of Rose City Development Company, Inc." (Tr. of R. p. 117).

17. May 23, 1968—Trustee files opening brief in this court.

ARGUMENT

A. Issues not properly before this court.

1. The trustee may not raise in this court for the first time the contention that a new financing statement and security agreement had to be signed and filed after the corporate merger of Portland Reporter Publishing Company, Inc. and Portland Newspaper Publishing Company, Inc., when this issue was not raised before the referee or before the District Court.

On December 15, 1964, the trustee in bankruptcy in this case filed his petition to have Rose City and other secured creditors pay over proceeds of assigned accounts (Tr. of R. p. 130).

On May 23, 1968, three years and six months later, the trustee raised in this court for the first time the contention that a new financing statement and security agreement had to be signed and filed after the corporate merger of Portland Reporter Publish-

ing Company, Inc. and Portland Newspaper Publishing Company, Inc. (Tr. Br. p. 10).

Since December 15, 1964, the bankruptcy docket contained in the transcript of record (p. 129 et. seq.) shows that the trustee filed objections to claims of secured creditors, three briefs before the referee, and three more briefs in the District Court. There were four days of trial before the referee and two oral arguments before the District Court. Yet at no time did the trustee consider this argument of the change of name of sufficient importance to raise it in any way.

11 U.S.C. sec. 47(a) gives this court authority "to review, affirm, revise, or reverse" the District Court. It is an imposition on this court to ask for consideration of a new issue.

The cases uniformly hold that a new issue in a bankruptcy proceeding cannot be raised for the first time in the Court of Appeals. *Briskin* v. *White*, 296 F.2d 132 (9th Cir., 1961); *In re Ben Weiss Co.*, 271 F.2d 234 (7th Cir., 1959); *O'Dell* v. *U. S.*, 326 F.2d 451 (10th Cir., 1964); *Britton* v. *Western Iowa Co.*, *In re Hicks-Fuller Co.*, 9 F.2d 488 (8th Cir., 1925). Each of these cases are bankruptcy appeals. The 7th, 8th, 9th, and 10th Circuits have all refused to consider new issues in bankruptcy appeals.[1]

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[1] See Appendix for a summary of other reasons why this new argument of the trustee should be ignored, which summary is presented without in any way waiving our contention that this issue is not properly before this court.

2. The trustee may not raise in this court the contention that the trustee may subrogate to any subordination rights of Davis against Rose City when Davis' subordination rights were denied by the District Court in its final order and excluded by the trustee in his notice of appeal.

On December 13, 1963, Rose City and the Reporter entered into an agreement which provided as follows:

> "The Accounts Receivable Loan and Security Agreement between the parties dated November 22, 1963 is hereby modified so as to provide that the agreement of this date between Reporter and Robert J. Davis and the assignment of accounts receivable which may take place from time to time in accordance with the provisions of that agreement shall take precedence over the agreement of November 22, 1963, between these parties." (Ex. 15)

Davis argued to the District Court that this was a subordination agreement which entitled Davis to be paid out of Rose City's assets. The trustee stayed neutral. After receiving briefs and oral argument Judge Solomon held that:

> "Neither counsel for Davis nor I have been able to find any authority for Davis' contention that his invalid claim should be paid from the amounts payable to Rose City on its valid claim . . . Davis' contention that he is entitled to payment from the accounts validly assigned to Rose City is therefore denied." (Tr. of R. p. 114)

On November 7, 1967, the same day as the mem-

orandum opinion, Judge Solomon entered his final order which provided as follows:

> "Based upon the opinions of the Court dated August 22, 1967, and November 7, 1967, the order of the Referee is affirmed except as to the claim of Rose City Development Company, Inc., which is reversed.
>
> The subordination agreement between Rose City Development Company, Inc., and the Portland Reporter Publishing Company, Inc., does not entitle Robert J. Davis to be paid out of the assets assigned to Rose City Development Company, Inc." (Tr. of R. p. 115)

The trustee then filed the following notice of appeal:

> "NOTICE IS HEREBY GIVEN, that Everette H. Williams, Trustee in bankruptcy of the above named, does hereby appeal to the United States Court of Appeals for the Ninth Circuit *from that portion of the Final Order* of the Honorable Gus J. Solomon, Judge of the United States District Court for the District of Oregon, entered in these proceedings on the 7th day of November, 1967, *reversing the order of the Referee disallowing the claim of Rose City Development Company, Inc.*" (Tr. of R. p. 117) (emphasis added).

The trustee thus made it crystal clear that he was appealing from the first paragraph of the final order and not from the second paragraph. Davis appealed from the second paragraph but then abandoned that portion of his appeal (Davis Br. 13). The second paragraph of the final order is now the law of this case. The

remand to the referee suggested by the trustee is useless because the referee is bound by Judge Solomon's unappealed decision (Tr. Br. p. 50). Davis has no subordination rights. The trustee can only claim subrogation rights as the privy of Davis. The trustee sought no subrogation rights either before the referee or the District Court. It is now too late to raise such a claim for the first time in this court. *DeVille* v. *Shell Oil Company*, 366 F.2d 123 (9th Cir., 1966); *Donovan* v. *Esso Shipping Co.*, 259 F.2d 65 (3rd Cir. 1958); *Ruckman and Hansen, Inc.* v. *Contracting and Material Co.*, 328 F.2d 744 (7th Cir., 1964); *Carter* v. *Powell*, 104 F.2d 428 (5th Cir., 1939), reh. den., 104 F.2d 1012 (1939), cert. den., 308 U.S. 611, 60 S. Ct. 173, 84 L. Ed. 511 (1939); and cases cited in Section 1 above.

B. Issues properly before this court.

1. Introduction

This case is apparently the first presented to any United States Court of Appeals in which a trustee in bankruptcy has challenged the legal validity of accounts receivable financing as authorized by the Uniform Commercial Code. The decision of Judge Solomon upholding the validity of the Rose City security agreement should be affirmed for the following reasons:

1. It upholds the intention of the parties to the Loan and Security Agreement.

2. It upholds generally accepted business practice.

3. It upholds the financing needed by small businessmen.

4. It upholds the intention of Section 60 of the Bankruptcy Act not to interfere with open secured credit not preferential in intention or fact.

5. It upholds the law of the state of Oregon.

6. It upholds the law adopted by Congress for the District of Columbia and by the legislature of every state in the union except Louisiana.

2. The District Court was correct in holding that the bankrupt did not give a voidable preference to the secured creditor, Rose City, when the level of assigned accounts receivable remained approximately constant during the four months before bankruptcy and always exceeded the amount of the debt.

Rose City loaned money to the Reporter and received an assignment of accounts receivable as security for the loan eleven months before bankruptcy. The original Rose City loan was $55,300 which was reduced at the time of the bankruptcy to $53,122.26 (Ex. 17). DuBay and Davis were other secured creditors who had interests in specific accounts to secure $50,000. On June 15, 1964, the balance of billed accounts of Reporter was $144,255.70. On September 28, 1964, the day when Rose City began collecting the accounts directly from the debtors in accordance with the security agreement, the balance was $141,463.48. The balance never fell below the June 27, 1964 total of $129,482.50. Circulation accounts of about $50,000 were billed at the end of June and 27/30th were earned on June 27th, so the total in accounts receivable on the low date was about $175,000 (Ex. 39).

Judge Solomon found that:

> "From June 15, 1964, to September 28, 1964, accounts totaling $397,860.24 were collected by *The Reporter*, and these were replaced by new accounts totaling $395,085.87." (Tr. of R. p. 100).

Section 60 of the Bankruptcy Act provides:

> "A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, *the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.*" 11 U.S.C. sec. 96 (a) (1) (emphasis added).

When the accounts receivable of a daily newspaper are assigned there is a continuous substitution of collateral. New advertising is placed in the paper and new papers are sold creating new receivables which replace the old receivables which are collected. Rose City was never unsecured because there always was more than an adequate level of receivables. There were no transfers to give Rose City a greater percentage of its debt since the level of accounts remained nearly a constant during the preference period until the time came when Rose City collected the accounts directly from the debtors. Thus there could be no preferential transfer.

Judge Solomon stressed:

"There is no preference when new accounts are substituted for released old ones. See: *In Re Pusey Maynes, Breish Co. Herr* v. *Philadelphia Nat. Bank*, 3 Cir. 1941, 122 F.2d 606."

* * * * *

"These figures show that Rose City shortly before *The Reporter's* bankruptcy did not try to improve its position or grab assets which belonged to all creditors in the same class. I find that Rose City did not receive a preferential transfer and that it has a valid security interest in all the accounts receivable of *The Reporter* whether they came into existence before or within four months of the bankruptcy" (Tr. of R. p. 100).

The brief of the trustee makes several arguments against this substitution of collateral portion of the District Court opinion:

1. "...[A] secured party who fails to police his collateral *probably* will be unable to demonstrate that the releases of collateral occurred at the requisite points in time." (Tr. Br. p. 44). (emphasis added)

Exhibit 39 shows the daily accounts receivable charges. These sums plus the unbilled circulation receivable which increased regularly during the month prove that there always was far more collateral than the $105,000 of secured debt. The trustee's "probably" argument, therefore, does not relate to the facts of this case.

2. "...[I]t is entirely likely that to some extent at least the figures in the credit column reflect the writeoff of uncollectible accounts or the issuance of credit memos." (Tr. Br. p. 45).

These comments are pure speculation without any support in the record. The trustee has the burden of proving a preferential transfer. *Keenan Pipe and Supply Co.* v. *Shields*, 241 F.2d 486 (9th Cir., 1956).

> 3. "Moreover, the figures do not show the account balances during any given day; the books apparently show balances only at the end of a day." (Tr. Br. p. 46).

These comments might have had some validity if the collateral consisted of a small number of receivables each of great value.

Actually, the Reporter on July 1, 1964, had more than 700 separate display advertisers and more than 600 classified advertisers (Ex. 33). The Reporter had over 50,000 subscribers (i.e., separate circulation receivables.) (Ex. 33). The margin of security over debt was such that no one collection no matter whether received before or after lunch could leave Rose City unsecured.

> 4. "...[T]he trustee was able to recover only a gross amount of approximately $127,000, and a net of only $107,000 after collection costs (Ex. 27)." (Tr. Br. p. 47).

The value of accounts receivable must be measured by their worth to a going business, not after bankruptcy. The fact that $127,000 could be collected up to the time of the hearing before the referee (with collections continuing) from over 50,000 separate advertising and circulation debtors is good evidence of the strength of the receivables. Indeed, this was in fact

more than was needed to cover the secured claims of Rose City, DuBay and Davis.

The case before this court has created a great deal of interest and many law review articles and comments have been written about the referee and District Court decisions.[2] Almost all of the commentators urge that accounts receivable financing under the Uniform Commercial Code be sustained. Many argue that a finding that there was a substitution of collateral and therefore no preferential transfer may be the fairest way of maintaining the billions of dollars of accounts receivable financing in the American economy.

The advantage of this approach is that it arises solely as the proper interpretation of Section 60 of the Bankruptcy Act and does not require a compar-

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[2] *After-Acquired Property Security Interests in Bankruptcy: A Substitution of Collateral Defense of the U.C.C.*, 77 Yale L. J. 139 (November, 1967); *Games Lawyers Play With the Bankruptcy Preference Challenge to Accounts and Inventory Financing*, William E. Hogan, 53 Cornell L. R. 553 (April, 1967); *The Interpretation of the Uniform Commercial Code: Article 9 in the Bankruptcy Courts*, Ray D. Henson, 22 U. of Miami L. R. 101 (Fall, 1967); *The Portland Case*, Ray D. Henson, 1 Ga. L. R. 257 (Winter, 1967); *The Code and the Bankruptcy Act: Three Views on Preferences and After-Acquired Property*, Sidney Krause, Homer Kripke, Charles Seligson, 42 New York U. L. R. 278 (April, 1967); *Bankruptcy Preferences—Secured Transactions—Security Interest in After-Acquired Property is Voidable Preference if Received Within Four Months of Bankruptcy—In re Portland Newspaper Publishing Co.*, 65 Mich. L. R. 1004 (March, 1967); *The Floating Lien Under the U.C.C.*, John W. Wyatt, 5 Am. Bus. L. J. 293 (Winter, 1967); *Secured Transactions —The Code in the Bankruptcy Courts, Some Significant Conflicts of Policy*, F. Anthony Malo, 85 Banking L. J. 19 (Jan., 1968).

ison with the language of the Uniform Commercial Code. It is also consistent with the practical expectancies of the parties to a security agreement. Debtor and secured creditor understand that entirely apart from any bankruptcy law theories the secured creditor only remains secured in fact if at any given time there is more security than debt. If the security ever falls below the debt, then another court in another case with those facts might look to the balance at the start and end of the preference period, or might hold that the secured creditor was only entitled to part of his security. But in our case Rose City never had a preference in fact because its security was always more than the debt.

The substitution of collateral approach does seem to be a good way of carrying out the admonition of Judge Solomon in his opinion below—"Good business practice should be good business law." (Tr. of R. p. 99). In our case this would sustain the Rose City security agreement.

3. The District Court was correct in holding that the "floating lien" section of the Oregon Uniform Commercial Code (which is identical with the law of the District of Columbia and every state except Louisiana) is valid.

a. The parties to the "Loan and Security Agreement" intended that the lien cover all present and future accounts receivable and their intention can be carried out.

On November 26, 1963, eleven months before bankruptcy, Reporter assigned to Rose City "all accounts

receivable of the debtor now existing or hereafter arising (herein called accounts)" (Ex. 17).

Section 60(a)(2) of the Bankruptcy Act provides:

> ". . . a *transfer* of property other than real property shall be deemed to have been made or suffered at the time when it became so far *perfected* that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." (11 U.S.C. sec. 96(a)(2) (emphasis added).

The first question presented is when were the accounts "hereafter arising" "transferred"—the date of the security agreement or the date when the advertising was placed in the Reporter and the charge placed on the company books. ORS 79.2040 (UCC 9-204) tells us that this happens when "the debtor has rights in the collateral" which cannot occur "until it comes into existence." The trustee argues that the collateral was the money due when each newspaper was sold or when each classified or display ad was placed in the Reporter. The collateral as defined by the trustee on any given day consisted of over 50,000 separate items, none of which "existed" the day before.

But is it necessary to fragment the collateral in this way? The newsboy on his route would consider each subscriber as the entity in existence, rather than each separate edition that he delivered to that subscriber. The Reporter advertising salesman would consider Montgomery Ward as one continuing, existing

advertising account. Rose City, the secured creditor, did not look to any particular subscriber or advertiser but rather to the total level of the accounts as one entity. The Loan and Security Agreement provides that "The aggregate amount of the loans shall not exceed 75% of the net value of the qualified collateral." (Ex. 17). Neither the borrower nor the secured lender, the two parties to the agreement being construed in this case, thought of the collateral or its existence as narrowly as defined by the trustee.

This issue of what is the collateral and when does it exist has now been decided by four United States District Courts. Every one has rejected the fragmentation sought by the trustee and ruled that the collateral was a single existing entity, and the transfer therefore took place when the accounts receivable assignment agreement was made. *Rosenberg* v. *Rudnick*, 262 F. Supp. 635 (D. Mass., 1967) (Ford, J.); *In re Portland Newspaper Publishing Company, Inc.*, 271 F. Supp. 395 (D. Oregon, August 22, 1967) (Solomon, J.) (Tr. of R. p. 89); *In re White*, 4 C.C.H. Installment Credit Guide § 97,945, p. 88,645 (S.D. Ohio, W.D., October 30, 1967) (Hogan, J.); *In the Matter of Grain Merchants of Indiana, Inc.*, Bankruptcy No. 7259 (N.D. Indiana, Fort Wayne Division, July 8, 1968) (Eschbach, J.)

The Massachusetts court stated in *Rosenberg* v. *Rudnick*, supra:

> "In applying sec. 60, however, inventory subjected to a security interest should be viewed

> as a single entity and not as a merge conglomeration of individual items each subject to a separate lien. 'In other words, the *res* which is the subject of the lien . . . is the merchandise of stock in trade, conceived of as a unit presently and continuously in existence—a 'floating mass,' the component elements of which may be constantly changing without affecting the identity of the *res.*' *Manchester National Bank* v. *Roche*, 1 Cir., 186 F.2d 827, 831. The whole security interest is in the entity as a whole, not in its individual components, and the transfer of property occurs when this interest in the inventory as an entity is created. *Matthews* v. *James Talcott, Inc.*, 7 Cir., 345 F.2d 374, 380." (262 F. Supp. at 639).

The Oregon court in our case set forth and approved this quotation from the Massachusetts case.

The Ohio court in *In re White*, supra, relied on the Massachusetts and Oregon cases without discussion.

The Indiana court in *In the Matter of Grain Merchants of Indiana, Inc.*, supra, stated:

> "In modern finance, it is far more realistic to view the entire stock of accounts receivable together as a single asset subject to a single security interest than to view individual accounts as separate assets subject to separate security interests." (citing the Massachusetts and Oregon cases). (Memorandum of Decision and Order at 18).

Another way of reaching the same result is by relying upon the portion of Section 60(a)(2) of the Bankruptcy Act which provides that there is no voidable preference when the lien has been "perfected" prior to the four month preference period. In the case of *In the Matter of Grain Merchants of Indiana, Inc.*, supra, the court pointed out:

> "The provision for time of transfer in Section 60(a)(2) of the Bankruptcy Act looks to the time when, under the applicable state law, subsequent lien creditors are precluded from establishing a claim superior to that of the transferee. Under Burns Ind. Stat. sec. 19-9-204(3), the Union Bank could and did acquire a security interest in Grain Merchants' stock of accounts receivable valid against 'lien creditors' at the time Union Bank filed its financing statement as required by the Indiana Uniform Commercial Code." (Memorandum of Decision and Order at 12).

The court in *Rosenberg* v. *Rudnick*, supra, also stresses that:

> "Perfection under state law need not be full perfection but only perfection *so far* as is necessary to meet the test of § 60(a)(2). While the Massachusetts law may not regard a security interest in after-acquired inventory as fully perfected until it attaches to items as they are acquired by the debtor, nevertheless § 9-204(3) recognizes that a lien in such inventory items can be validly created by a security agreement." (262 F. Supp. at 638).

Thus the *Rosenberg* case holds that the lien is perfected for the purposes of Section 60 whether or not the receivable then "exists."

Whether stress is placed on the word "transfer" or the word "perfected" in Section 60(a)(2) of the Bankruptcy Act, the same result is reached—the security interest of Rose City attached to the receivables "hereafter arising" on November 22, 1963, the date of the security agreement.

The accounts receivable of the Reporter should be considered as a group. The result will be that the lien attaches to the "accounts" in accordance with the practical understanding of the parties to the Loan and Security Agreement," and their intention will be carried out.

b. The Oregon Uniform Commercial Code specifically protects the Rose City lien and there is nothing in federal law which requires a contrary conclusion.

The federal Bankruptcy Act provides that:

> "A preference is a transfer of . . . any of the property of a debtor . . . for or on account of *an antecedent debt* . . .". 11 U.S.C. 96(a)(1) (emphasis added).

Federal law does not define "an antecedent debt." Judge Ford in *Rosenberg* v. *Rudnick* says that state law cannot be looked to for a definition. This court has stated:

> "Nor does the fact of bankruptcy, save insofar as is specifically provided for in the Bankruptcy Act (11 USCA), affect the validity of

> liens authorized by state law." *Mason* v. *Citizens' National Trust and Savings Bank*, 71 F.2d 246, 248 (9th Cir., 1934).

Since state law defines the validity of the lien, it can be argued that state law can define the meaning of the words that determine validity. The Oregon law provides:

> "Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given." ORS 79.1080 (UCC 9-108).

Rose City has complied with all the requirements of this section. Rose City advanced money, was given security in part by after-acquired property, and the Reporter acquired its rights in the accounts receivable in the ordinary course of its business. Therefore Rose City's security interest in the accounts receivable "hereafter arising" "shall be deemed to be taken for new value."[3]

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[3] The trustee suggests that Rose City did not in fact give new value (Tr. Br. p. 25). On November 22, 1963 Rose City loaned $10,300 of new money and received a security agreement covering that loan and the $45,000 consolidated in one

The Congressional history of the federal Bankruptcy Act makes clear that no conflict was intended with normal accounts receivable financing. There is a careful analysis of the 1950 House of Representatives reports which accompanied the latest amendments to Section 60 of the Bankruptcy Act in *In the Matter of Grain Merchants of Indiana, Inc.*, supra:

> "Congress was not satisfied with the effect which its 1938 version of Section 60 had upon secured credit, so in 1950 Congress once again amended Section 60. This amendment put Section 60 in its present form. The House Report which accompanied the 1950 amendment states:
>
> > '. . . In 1938 the Bankruptcy Act was amended to obviate the effect of [the *Sexton*, *Bailey*, *Carey*, and *Martin* cases described above], which were regarded with disfavor by

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promissory note six days earlier (Tr. p. 237). ORS 71.2010 (44) defines "Value" as follows:

> "Except as otherwise provided with respect to negotiable instruments and bank collections in ORS 73.3030, 74.2080 and 74.2090, a person gives 'value' for rights if he acquires them: . . .
>
> (b) As security for or in total or partial satisfaction of a preexisting claim; or . . .
>
> (d) Generally, in return for any consideration sufficient to support a simple contract." (U.C.C. 9-201 (44)).

Bender's UCC Service, *Secured Transactions Under UCC*, sec. 4.05, p. 284 points out, "It is clear from subsection (44) (b) of 1-201 that a security interest may secure payment of an antecedent debt." Alternatively, there was ample consideration to support a simple contract. According to 1 Corbin, *Contracts*, sec. 127: "That which is bargained for by the promissor and given in exchange for the promise by the promissee is not made insufficient as consideration by the fact that its value in the market is not equal to that which is promised." Rose City also gave the consideration of releasing the receivables on March 4, 1964 when by agreement Reporter was again allowed to make collections from the account debtors (Ex. 39).

> the great majority. But in so doing, the authors of the amendment went further than was necessary, and it brought about results which they did not anticipate. The amendment placed the trustee in the position of an artificial bona fide purchaser, and, by so doing, unintentionally invalidated many types of liens acquired in good faith and for value, in normal and accepted business and financial relationships . . . . The resultant confusion has cast grave doubt upon the validity of normal business security . . . H.R. Rep. No. 1293, *supra*, 2 U.S. Code Cong. Service at 1986, 1987.'

It is therefore clear that in adopting Section 60 as it now reads, Congress intended not only to invalidate 'secret' liens, Congress also intended to give effect to legitimate forms of secured financing created in accordance with state law. The House Report clearly stated this latter purpose:

> '. . . The present [1938] language of the act tends to impede and choke the flow of credit, principally to small businessmen, and the object of the bill is to free its channels.' H.R. Rep. No. 1293, *supra*, 2 U.S. Code Cong. Service at 1985.

It would be exceedingly ironic if language in a statute which was intended to facilitate secured financing were construed in a manner which discouraged such financing. Nothing in the language or purposes of Section 60 compels such a construction." (Memorandum of Decision and Order at 16-17).

There is a similar analysis in 65 Mich. L. R. 1004, 1009, supra.

In 1965, after the passage and amendment of Section 60 of the Bankruptcy Act, Congress enacted the Uniform Commercial Code for the District of Columbia, including the identical wording that is contained in ORS 79.1080 (D.C. Sec. 28:9-108). It is a basic principle of statutory construction that when the same body passes two statutes, they are to be construed if possible to avoid any conflict, and if this is not possible, the later statute controls. 2 Sutherland, Statutory Construction (3rd ed. 1943) § 5201.

The U. S. Supreme Court has stated in *St. Louis Ry.* v. *U. S.*, 251 U.S. 198, 207, 40 S. Ct. 120, 64 L. Ed. 225 (1919) that:

> "Congress must be presumed to have known of its former legislation . . . and to have passed the new laws 'in view of the provisions of the legislation already enacted.' "

New Jersey v. *Anderson,* 203 U.S. 483, 489, 27 S. Ct. 137, 51 L. Ed. 284 (1906) is a similar case specifically dealing with a bankruptcy problem. This rule of statutory construction which allows the more recent statute to control should be especially true in dealing with the Uniform Commercial Code. See *U. S.* v. *Wegematic Corporation,* 360 F.2d 674, 676 (2d Cir., 1966).

Judge Ford in *Rosenberg* v. *Rudnick,* supra, held as a matter of federal law:

> "In view of the fact that the Uniform Commercial Code has now been adopted by 48 states, it would seem that the definition of § 9-108 should be regarded as generally accepted and in

> accord with current business practice and understanding and hence applied in bankruptcy." (262 F. Supp. at 639).

Judge Solomon in our case set forth this quotation and said, "I agree with Judge Ford's decision." (Tr. of R. p. 98).

There is no reason why the law of Oregon, every state in the union except Louisiana, and the District of Columbia should be invalidated because of undefined language in Section 60 of the Bankruptcy Act. The same result is reached whether we construe Section 60 in light of good business practice, let the term "antecedent debt" be defined by state law, look to the Congressional history of Section 60, or rely on the intention of Congress in passing the Uniform Commercial Code for the District of Columbia.

CONCLUSION

The language of *Rosenberg* v. *Rudnick*, supra, could properly apply to the Rose City security agreement:

> "The transaction here was not one of those which the provisions of Sec. 60 were designed to avoid. There was nothing here in the nature of a secret lien. There was no attempt by one creditor to outrace others at the last moment before bankruptcy. Defendant here bargained for and acquired his security interest at the time he made his loan." (262 F. Supp. at 639).

Judge Solomon sums up the situation this way:

"The business community has depended upon a revolving or flow type of accounts receivable financing for many years. The trustee and Referee both concede that Rose City would have had a valid security interest if *The Reporter* had deposited the collected accounts in a separate bank account for the benefit of Rose City and then received a new loan, daily if necessary, equal to the amount of the deposit. The Code allows a financial institution or other creditor to make a loan secured by present and future accounts and permits the debtor to use the full amount of the loan without routing the proceeds of the old accounts through a cash collateral account. The old method was both expensive and cumbersome and necessarily increased the cost of money. I can find nothing either illegal or unethical in the arrangement sanctioned by the Code.

Good business practice should be good business law." (Tr. of R. p. 98-99).

The decision of the District Court upholding the security agreement of Rose City should be affirmed.

Respectfully submitted,

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APPENDIX

The Change of Name of the Bankrupt Does Not Invalidate the Security Agreement or Financing Statement.

From February 8, 1960 until April 22, 1964, the Portland Reporter was published by Portland Reporter Publishing Company, Inc. at 1714 N. W. Overton Street, Portland, Oregon (Ex. 33). On March 20, 1964 a new corporation was formed, Portland Newspaper Publishing Company, Inc., which entered into a Plan for and Merger Agreement with Portland Reporter Publishing Company, Inc. on March 27, 1964, subject to stockholder approval (Ex. 1). Over two-thirds of the stock held by over 8000 stockholders of Portland Reporter Publishing Company, Inc. approved the merger on April 22, 1964, and the Articles of Merger were filed with the Oregon Corporation Commissioner on April 30, 1964 (Exs. 1 and 5). The surviving corporation continued to publish the Portland Reporter at 1714 N. W. Overton, Portland, Oregon (Ex. 33). The Portland Reporter was a daily newspaper with a circulation of over 50,000 (Ex. 33). There is no evidence in this record of the extent to which this corporate merger of a daily newspaper was general knowledge in Portland.

The security agreement and financing statement remain valid for any of the following four reasons:

1. The surviving corporation in a merger has the liabilities and duties of the predecessor corporation including its liabilities and duties under the Accounts Receivable Loan and Security Agreement.

The merger agreement provides that the surviving corporation:

> "without other transfer, shall succeed to and possess all of the rights, privileges, powers, and immunities of Reporter and PNP, and shall be subject to the liabilities and duties of Reporter except as otherwise provided herein or in the Articles of Incorporation or By-Laws of PNP." (Ex. 19).

There are no limitations contained in the Articles or By Laws (Ex. 1).

ORS 57.480 provides for the "effect of merger or consolidation," including the following:

> "When such merger or consolidation has been effected: (1) The several corporations parties to the plan of merger or consolidation *shall be a single corporation*, which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation. . . ."
> (5) Such surviving or new corporation shall thenceforth be *responsible and liable for all the liabilities and obligations of each of the corporations so merged* or consolidated; and *any claim existing* or action or proceeding pending by or against any of such corporations *may be prosecuted as if such merger* or consolidation *had not taken place*, or such surviving or new corporation may be substituted in its place. *Neither the rights of creditors nor any liens upon the property of any such corporation shall be impaired by such merger or consolidation*." (emphasis added).

Even after the merger, Rose City could have sued

Portland Reporter Publishing Company, Inc. for a breach of the security agreement. No rights of Rose City or liens upon accounts receivable "*shall be impaired by the merger.*" This was "*a single corporation.*" Its accounts receivable continued to be subject to Rose City's security agreement by operation of Oregon law.

There appear to be no Oregon cases on the effect of this statutory language. In *Jackson* v. *Continental Telephone Company*, 28 Cal. Rptr. 1, 212 Cal. App. 510 (1963), the California court quoting from another case stated:

> "Although the distinct corporate entity of [the old corporation] passed out of existence or became extinct upon the completion of the act of consolidation, its corporate activities did not cease but were continued and carried on through the new channel. . . The consolidation did not create an entirely new entity but 'merely directs the blood of the old corporation into the veins of the new, the old living in the new.' "

In a Texas case, *Morris Plan Life Insurance Co.* v. *Wells*, 387 S.W.2d 84 (Tex. Civ. App., 1965) it was held:

> "Any claim may be prosecuted as if such merger had not occurred. Neither the rights of creditors nor any lien shall be impaired by such merger." (387 S.W. at 87).

In both cases the statute was similar to ORS 57.480 and the surviving corporation was held liable for the debts of the old corporation.

2. Under the Oregon Uniform Commercial Code a financing statement remains effective for five years, without regard to any change of name of the debtor.

ORS 79.4030(2) provides in part:

> "A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of 60 days. Any other filed financing statement is effective for a period of five years from the date of filing." (UCC 9-403(2)).

No action of the debtor in merging with another corporation, changing its name, or even transferring the collateral can defeat the rights of the secured party. There is no requirement that a new financing statement be filed by the secured creditor if any of these events occur. If this were not so, no lender could ever rely on the protection of the Uniform Commercial Code.

3. Under the Oregon Uniform Commercial Code the security interest continues in the collateral notwithstanding transfer by the debtor.

ORS 79.3060(2) provides:

> "Except where ORS 79.1010 to 79.5070 otherwise provide, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also con-

> tinues in any identifiable proceeds including collections received by the debtor." (UCC 9-306(2)).

This section makes even clearer that a transfer of the collateral by the debtor cannot defeat the secured creditor. The trustee argues that the accounts receivable at issue "are the bankrupt's accounts; they never belonged to the predecessor corporation." This is just a reargument of the trustee's basic disagreement with Judge Solomon's decision. The accounts receivable of the Reporter were one group, with new collateral continually substituting for old collateral.

4. Under the Oregon Uniform Commercial Code minor errors in the financing statement do not affect its validity.

ORS 79.4020(5) provides:

> "A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." (UCC 9-402(5)).

The financing statement was filed showing the debtor as Portland *Reporter* Publishing Company, Inc., and signed by Robert D. Webb (Ex. 3), while the name of the surviving corporation was Portland *Newspaper* Publishing Company, Inc. The same newspaper continued to be published at the same address (Ex. 33). There is no evidence that any supplier or employee (trade creditors) of the newspaper was misled in any way. If any supplier or employee was in doubt about the merger or its effect, an inquiry at

1714 N. W. Overton Street would have produced the necessary information.

In the case of *In the Matter of Excel Stores, Inc.*, 341 F.2d 961 (2nd Cir., 1965), the name of the debtor in the security agreement was listed as "Excel Department Stores" rather than the correct name of "Excel Stores, Inc." The opinion noted that Excel did business with its name "Excel" prominently displayed on the store. The court there applied this same statutory section and held that this was a minor error not seriously misleading:

> "It is clear that the parties intended to execute a valid and binding contract . . . Nor can it be doubted that any creditor of Excel or other interested person searching the record would come to the Excel Department Store at the Shopping Center of Pawcatuck, find Machado's name and be put on notice that a lien against Excel might be outstanding and that communication with Machado might be appropriate. This is precisely all that the code requires. See Official Comment to U.C.C. Section 9-402." (341 F.2d at 963).

Communication with Robert D. Webb, publisher of Reporter before the merger and assistant publisher after the merger (Ex. 33) would have been appropriate for any trade creditor.

Another similar case is the referee's decision in *In re Bengtson*, 40 Conn. Bar J. 57, 3 U.C.C. Rep. Serv. 283 (D. Conn, 1965). The debtor was Bruce R. Bengtson and he signed the form, but the debtor was shown on the financing statement as "Bruces

Vernon Circle Serv., Vernon, Connecticut." The referee points out, "A telephone inquiry to the Secretary of State failed to disclose any record of a financing statement having been filed in the bankrupt's name." (3 U.C.C. at 287). Despite this, the referee upheld the validity of the financing statement saying that

> ". . . all that the statute requires is the *signature and mailing address* of the debtor." (3 U.C.C. at 287).

The trustee then attacked the sufficiency of the address, but the referee responded:

> "Even though it is not as precise as it could be, the criterion should be whether it is sufficient to enable mail to be delivered. Vernon Circle is a well known landmark and mail would be delivered there." (3 U.C.C. at 287).

Other cases to the same effect are *In the Matter of Kulesza*, 4 U.C.C. Rep. Serv. 66, 4 U.C.C. Installment Credit Guide par 98,076, p. 88,749 (W.D. Mich., 1967) and *In re Vaughan*, 4 U.C.C. Rep. Serv. 61 (W.D. Mich., 1967) where misspellings on the certificate of title in one case and on the financing statement in the other were upheld since there was adequate notice and no one was misled. In our case, there was adequate notice and there is no evidence that anyone was misled.

No. 22507

United States
COURT OF APPEALS
for the Ninth Circuit

In the Matter of

PORTLAND NEWSPAPER PUBLISHING COMPANY, INC.,

Bankrupt,

R. ANTHONY DUBAY,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of PORTLAND NEWSPAPER PUBLISHING COMPANY, INC.,

Appellee.

REPLY BRIEF OF APPELLANT R. ANTHONY DUBAY

On Appeal from the United States District Court for the District of Oregon

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REPLY BRIEF OF APPELLANT R. ANTHONY DUBAY

A. The trustee concedes that the parties to the security agreement intended to assign to DuBay the fluctuating balances in certain named advertising accounts.

In opening brief DuBay contended that when the parties assigned the Montgomery Ward account (or

other named accounts) they intended to assign the fluctuating balance in that account, not merely the balance on the date of the security agreement.

The trustee in his answering brief to DuBay contends:

> "All demonstrative evidence indicates that they did not intend to assign 'future accounts.'" (Tr. Br. (DuBay) p. 7).

The conclusive reply to the trustee is that in his opening brief to Rose City in this same case, the same trustee concedes:

> "TESTIMONIAL EVIDENCE WOULD SEEM TO ESTABLISH THAT THE PARTIES INTENDED DAVIS AND DuBAY TO HAVE ALL ACCOUNTS WHICH BECAME OWING AT ANY TIME FROM THOSE NAMED ACCOUNT OBLIGORS (R. Tr. pp. 86, 88-90, 94, 155)." (Tr. Br. (Rose City) p. 46). (emphasis added)

B. The trustee concedes that the parties intended periodically to modify the agreement by assigning new advertising accounts.

In opening brief DuBay contended that the security agreement of July 31, 1962 was intended to be modified by later assignments of accounts on various dates up to April 21, 1964.

In the trustee's opening brief to Rose City in this same case, the same trustee concedes:

> "While the courts below held the procedure invalid, the uncontradicted testimony is that in

> preparing the new lists the Reporter intended to comply with the DuBay and Davis agreements (R. Tr. pp. 41-44) * * *." (Tr. Br. (Rose City) p. 46).

These two concessions of the trustee mean that the admitted intention of Reporter and DuBay was to enter into a security agreement with periodic modifications which assigned the fluctuating balances in certain named advertising accounts. In the case of *In re Taylored Products, Inc.*, 5 U.C.C. Rep. 286 (D.C., W.D. Mich. Ref. op., 1968) cited by the trustee (Tr. Br. p. 7) the referee found no intention to assign future accounts.

The parties in our case intended that the word "account" have a meaning different than the definition of "account" later set forth in the Uniform Commercial Code. The facts are established. The question remains whether the intention of the parties can be carried out under Oregon law.

C. Contrary to the contention of the trustee, the DuBay agreement and its modifications were valid security agreements under the Uniform Commercial Code.

After the Uniform Commercial Code became effective in Oregon on September 1, 1963, DuBay took four affirmative actions:

1. September 30, 1963—DuBay filed a financing statement in accordance with Oregon law, signed by both parties, showing an assignment of accounts receivable and their proceeds (Ex. 3).

2. December 18, 1963—DuBay signed a guarantee agreement with the bank which pledged his general assets to the repayment of the Reporter loan (Ex. 16). This was new and additional value since the collateral pledge signed in June, 1962 limited DuBay's liability to the collateral which, of course, might fluctuate in value (Ex. 16).

3. November 30, 1963, February 24, 1964 and April 21, 1964—New assigned accounts were received by DuBay from Reporter (Tr. pp. 22-23).

4. March 6, 1964—At the conclusion of a week in which DuBay had required that the assigned accounts be paid directly to him by the account debtors, an agreement was signed between DuBay and Reporter which provided among other matters:

> "1. All agreements and assignments between the parties hereto, or any of them, are hereby affirmed and shall continue in full force and effect." (Ex. 39)

The trustee cites *Scott* v. *Stocker*, 380 F.2d 123 (10th Cir. 1967) for the proposition that "The mere filing of a financing statement after the effective date of the Code was ineffectual to validate that agreement." (Tr. Br. p. 14). In our case there was far more than "the mere filing of a financing statement." In addition there was a specific reaffirmation of the earlier agreements, after the effective date of the Code.

The DuBay agreement became valid after the September 1, 1963 effective date of the Code upon the

filing of the September 30, 1963 financing statement and execution of the March 6, 1964 reaffirmation agreement. It continued valid as modified after the April 21, 1964 assignment of new accounts by typed assignment memorandum and assignment stamp on the ledgers, coupled with the March 6, 1964 agreement of assignment of "future accounts receivable assigned or to be assigned pursuant to said agreements."

The trustee cites four cases which hold that a financing statement or a promissory note are not security agreements: *American Card Co., Inc.* v. *HMH Co.*, 97 R.I. 59, 196 A.2d 150 (1963); *Mid-Eastern Electronics, Inc.* v. *First National Bank of Southern Maryland*, 380 F.2d 355 (4th Cir. 1967); In re *Vielleux*, 5 U.C.C. Rep. 277 (D. Conn. Ref. op., 1967); *In re Fernandes Welding & Equipment Service, Inc.*, 5 U.C.C. Rep. 1 (1st Cir. 1968). In our case we have a security agreement, a series of modifications of the agreement and an agreement describing the security agreement and its modifications as assigning future accounts receivable.

The parties understood their agreement and acted under it for 27 months. Creditors had notice. The benefits of continued publication of Reporter went to those who received payment for goods and services. DuBay neither sought or received any benefit. To call such an arrangement a fraudulent preference misconstrues the whole purpose of the Bankruptcy Act.[1]

---

[1] As done by other parties, DuBay incorporates by reference in this brief the arguments contained in Rose City's brief dealing with points not covered herein.

CONCLUSION

The decision of the referee should be reversed as to DuBay and DuBay should be awarded his security interest in the assigned accounts receivable in accordance with the admitted intention of the parties.

Respectfully submitted,

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No. 22507

United States
COURT OF APPEALS
for the Ninth Circuit

ROBERT J. DAVIS,

Appellant,

v.

EVERETTE H. WILLIAMS,

Appellee.

Appeal from the United States District Court for the District of Oregon

HONORABLE GUS J. SOLOMON, Judge

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

REPLY TO APPELLEE'S STATEMENT OF THE CASE

It is unnecessary to reply to appellee's statement of the case except to state that appellee's observation that appellant's statement contains irrelevant and immaterial matters is not correct. Appellant's full and complete statement of the case is necessary for a proper analysis and interpretation of the transaction and the documents utilized therein.

SUMMARY OF REPLY ARGUMENT

The Davis December 13, 1963 agreement, which was identical with the DuBay July 31, 1962 agreement, must be construed in the light of the course of dealing relating thereto. As thus construed it must be deemed to have been modified so as to have waived or eliminated the need of formal assignments of accounts receivable, and merely have required lists of accounts receivable subject to a security interest in favor of Davis. Independently thereof the lists should be regarded as security agreements—they are designated as accounts receivable assignments, import grant and satisfy the requirement for a signing. Further future charges to the specifically named advertising accounts receivable assignments and circulation accounts receivable were covered.

The assignment of account receivable balances created within four months of the filing of the involuntary petition in bankruptcy did not constitute a preference under the Bankruptcy Act.

Appellant's claim is not rendered invalid either because paragraph 7 of the Davis December 13, 1963 agreement provided that the Portland Reporter Publishing Company remained the "sole owner" of the accounts receivable and their proceeds until default. Nor is the claim invalid on the ground that the accounts receivable belonged to the Portland Newspaper Publishing Company, Inc., the bankrupt, as distinguished from the Portland Reporter Publishing Co., Inc., the original debtor, which was merged into the bankrupt.

REPLY TO ANSWER TO SPECIFICATION OF ERROR NO. 1

Appellee's answer to specification of error No. 1 makes clear that appellee is either unable or unwilling to recognize the import of the appellant's argument. Appellee must be of the view that the Uniform Commercial Code is to be applied in a highly technical fashion and accordingly seeks to examine, construe and interpret the documents in a vacuum and with complete disregard for the background and circumstances of the particular transaction. Further, appellee implies that appellant seeks "a sympathetic consideration of particular facts" because of the "assistance of a 'public-spirited citizen' to a struggling business" (Br. p. 5). There is no plea by appellant for "sympathetic consideration" of a charitable nature as thus implied. Appellant simply asserts that the documents and the transaction must necessarily be viewed in the light of the circumstances which obtained, and further, that in the process, the clear intent of the Code, as set forth in U.C.C. § 1-102(1) thereof that "This Act shall be liberally construed and applied to promote its underlying purpose and policies" be kept in mind.

Specifically, appellee argues that appellant is attempting to utilize a course of dealing to create a security agreement where there is none and that assignment forms were not used as specifically required by the underlying Davis agreement of December 13, 1963, secondly, that the memoranda and lists of February 24 and April 21, 1964, and particularly

that of April 21, do not constitute security agreements in that they do not contain words of grant and are not signed, and thirdly, that neither future charges to named advertising accounts nor circulation accounts are covered.

First, appellee argues that appellant can not be aided by the course of dealing and course of performance with respect to the DuBay agreement and the parties' understandings thereto, in part because the trustee contends the DuBay agreement is invalid and the Davis agreement is on a parity with it.

That the DuBay agreement may be invalid does not adversely affect Davis' contention based upon the course of dealing relative thereto. (The DuBay agreement, which was entered into prior to the enactment of the code, was deemed invalid by the referee because of the doctrine of *Benedict* v. *Ratner*, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 991 (1925), which prevailed at that time.) Appellant's contention is that the course of dealing modified the DuBay agreement and made unnecessary the execution of specific and formal assignments as originally contemplated by the DuBay agreement. In other words, notwithstanding the specific provisions of paragraph 2 of the DuBay July 31, 1962 agreement—and likewise paragraph 2 of the Davis December 13, 1963 agreement—that accounts receivable be assigned by "a proper instrument in writing, a form of which is attached hereto" the effect of the practice which was in fact followed by DuBay and the Portland Reporter was to modify the original agreement so that the requirements of such

paragraph either were waived or were met by the mere supplying of a list. (See argument, Appt. Br. p. 19-25) and quotation from and discussion of In re Bengston, 3 UCC Rep. 283 (D.C., Conn., Ref. Op. 1965) in Appendix hereto which through error was omitted from Appendix to Appellant's Opening Brief.)

This does not constitute seeking to create a security agreement. The security agreement in the first instance consisted of the basic agreement and the assignment—in the case of DuBay the agreement of July 31, 1962 and the assignment of that date, and in the case of Davis the agreement of December 13, 1963 and the assignment of that date. Subsequently the security agreement consisted of the basic agreement plus the subsequent lists. The situation is as if the Davis December 13 agreement either were incorporated in the lists of February 24 and April 21 or as if that agreement was the basic and continuing security agreement with the lists merely serving the function of designating the specific accounts receivable, both advertising and circulation, covered by such continuing security agreement.

Secondly, the trustee contends that the lists do not constitute security agreements because they are not in the form of the assignment, a copy of which was attached to the December 13, 1963 agreement, do not contain words of grant and are not signed.

This contention overlooks the argument just made as to why such formal assignments are unnecessary. Also, it disregards and rejects appellant's contention,

elaborated upon in his brief, (Appt. Br. p. 25-32) that the memoranda are designated as accounts receivable assignments and that the headings and other language contained therein import a grant.

The trustee then indulges in a complete non sequitur (Br. p. 7) and observes that if the memoranda imports grant then appellant could also argue that the financing statement filed would be sufficient as a security agreement since it includes words such as "accounts receivable." Appellant has not even suggested or intimated, let alone argued, that a financing statement—at least one which does not also meet all of the requirements of a security agreement—dispenses with the need of a security agreement or that the financing statement in this instance did so. Appellant concedes that a security instrument is necessary.

The cases, *American Card Company* v. *H.M.H. Co.*, 97 R.I. 59, 196 A.2d 150 (1963) and *Scott* v. *Stocker*, 380 F.2d 123 (10 Cir. 1967) cited by the trustee, as well as his observation, are beside the point. All that the *American Card Company* case holds is that a financing statement which does not contain the debtor's grant of a security interest can not serve as a security agreement.

Scott v. *Stocker* holds that a pre-code agreement filed after the effective date of the code could not validate a floating lien which was invalid under pre-code law, and that to create a valid security interest there must be a security agreement as well as a financing statement, a view with which appellant agrees.

Other cases cited by him, *In re Fernandez Welding and Equipment Service, Inc.*, 5 U.C.C. Rep. 1, — F.2d — (1 Cir. 1968) and *In re Vielleux*, 5 U.C.C. Rep. 277 (D. Conn., Ref. Opp. 1967) are inapposite. The documents involved in those cases were promissory notes, designed as such and not used or purported to be used as security agreements.

As to the lack of signature, appellant reiterates his argument commencing on page 27 of his opening brief. The fact that the reported cases dealing with the question of what constitutes a signing are those involving financing statements does not detract from the construction and determination of what amounts to a signing under the code. The determination of this question is the same whether the instrument is a financing statement, a security agreement or some other document.

Mid-Eastern Electronics, Inc. v. *First National Bank*, 380 F.2d 355 (4 Cir. 1967), cited by appellee (Br. p. 10), U.C.C. § 9-203 (ORS 79.2030) admittedly speak of a signed writing and the need of a debtor having signed a security agreement. However, they do not state or treat of what constitutes signing. Appellant has not contended that the signing of a security agreement is unnecessary. What appellant has urged and argued is that the typewritten name of the debtor "FROM: KEITH PLOTNER, CONTROLLER" on memoranda addressed to the Board of Directors of the debtor and the creditor constituted a signing.

Thirdly, are the future charges to the specifically

designated advertising accounts receivable and all circulation accounts and the future charges to all circulation accounts receivable covered? The trustee has asserted that the only accounts receivable in which appellant obtained a security interest were the balances existing in the specifically designated advertising accounts on December 13, 1963 when the Davis agreement and the formal assignment of that date were executed. Presumably, if the memoranda of February 24 and April 21, 1964, either independently or with the aid of the Davis agreement of December 13, 1963, be held to constitute security instruments, then it would be the trustee's position that only the existing balances owing on the advertising accounts specifically designated in such lists on the dates thereof would have been covered.

Appellant has discussed this issue at some length in his opening brief at pages 35 to 39 to which reference is made. It is sufficient at this point to repeat the following observations.

(1) If the trustee's contention is valid then appellant's security interest would have immediately been extinguished and eliminated by the payment of such balances and would have been reduced pro tanto by the making of any single payment; and this result would follow even though additional charges were made to such accounts either before, simultaneous with or after the payments and even though the balances were greater after such payments and charges than prior thereto. This would have made for an im-

possible situation and the preservation of appellant's security interest would have required, according to trustee's position, a new formal assignment of a newly created account receivable balance each time any payment was made upon any specifically designated advertising account. Such a forced and arbitrary construction is untenable.

(2) The specific designation of particular advertising accounts receivable precluded appellant obtaining a security interest in other advertising accounts receivable. However, it clearly follows from paragraph 1 of the Davis December 13, 1963 agreement, and the intention thereof, as indicated by its language, that the fluctuating balances from time to time of such accounts receivable and not the specific balances of such accounts receivable on a specific date were covered. This necessarily means that future charges to the specifically designated accounts receivable and not merely the balances on the dates of the lists were subject to appellant's security interest.

(3) While the Davis December 13, 1963 agreement made no reference to circulation accounts, the assignment and the list of that date attached to said agreement at the time of its execution were a part thereof. The list and the testimony relative thereto (Tr. pp. 69-70) make transparently clear that to provide appellant with the security contemplated, namely \$35,000 of accounts receivable, the inclusion of circulation accounts was necessary. The agreement must be deemed modified accordingly to include circulation accounts.

(4) The meaning of "circulation accounts" is clear—it was clear to the parties and the term is clear to anyone having the slightest knowledge of newspaper operations. Moreover, the term "circulation accounts receivable" is included within the generic term "accounts receivable." Further, all circulation accounts were covered. The Referee and the District Judge had no difficulty in determining that accounts receivable, in the case of Rose City Development Company, Inc., included all advertising accounts receivable. There should be no difficulty in likewise determining that circulation accounts receivable includes all circulation accounts receivable, particularly when it is noted that where it was intended to cover less than all advertising accounts receivable, specific accounts recceivable were designated.

Appellant argued in his opening brief, and repeats his argument (Appt. Br. p. 34), that the accounts receivable in which he had a security interest consisted of (a) certain specifically designated advertising accounts receivable and their fluctuating balances from time to time, and, (b) all circulation accounts receivable and their fluctuating balances from time to time, provided, however, that appellant could reach only that amount of the circulation accounts receivable balances as was specified in a particular list. This means on the basis of the April 21 memorandum appellant had a security interest in all balances of all circulation accounts receivable, but that he could not realize therefrom more than $18,752.56, the amount specified in the April 21 memorandum. However, ap-

pellant has urged that if the April 21 memorandum be deemed ineffective, the trustee having conceded (Br. pp. 4-5) that the December 13, 1963 agreement and the assignment attached thereto did create a valid security agreement, appellant must of necessity, the December 13, 1963 list being a part of the assignment, have a valid security interest in all balances of all circulation accounts and must recover not less than $7,837, the amount specified in the list attached to the agreement and assignment of December 13, 1963.

REPLY TO ANSWER TO SPECIFICATION OF ERROR NO. 2

Trustee's answer to specification of error No. 2 consists of the incorporation of the trustee's argument in his brief in Appeal No. 22507-A, *Everette H. Williams, Appellant*, v. *Rose City Development Company, Inc., Appellee.* It is appellant's position that the extension of his security interest to new charges to accounts receivable covered by the security agreement, which charges came into existence within four months of the commencement of the bankruptcy proceedings was not preferential. With reference to this issue and in support of his position, appellant restates the argument in his opening brief (Appt. Br. pp. 39-54) and incorporates by reference herein the arguments contained in the brief amicus curiae of the Permanent Editorial Board for the Uniform Commercial Code and the argument in the answering brief of appellee in the same appeal, Appeal No. 22507-A.

REPLY TO APPELLEE'S OTHER REASONS FOR CONTENDING THAT APPELLANT'S CLAIM IS NOT SUSTAINABLE

Appellee sets forth two additional reasons which "Appellant has not dealt with" for contending that appellant's claim must fail. The first is that the December 13, 1963 agreement "specifically provides that until default, the assignor remains the *sole owner* of the accounts and their proceeds" (Br. p. 15), and the second is that appellant has no valid perfected interest in the accounts receivable whose proceeds were collected and which are in issue because these accounts receivable belonged to the Portland Newspaper Publishing Company, Inc., Bankrupt, as distinguished from The Portland Reporter Publishing Company, Inc., the original debtor.

As to the first of these reasons, it is somewhat surprising that it is even advanced. It is the very essence of a security interest that the asset in which the creditor claims such interest is owned by the debtor and not the creditor. Any ownership interest in a creditor, that is, a title interest as distinguished from a lien or security interest, has been eliminated by the Uniform Commercial Code itself. Thus the Uniform Commercial Code in Section 9-102(2) (ORS 79.1020(2)) specifically provides that Article 9 applies to security interests created by, among other instruments, conditional sales, trust receipt and other title retention contracts.

The language in paragraph 7 of the Davis December 13 1963 agreement stating that until default the

assignee shall not be entitled to the proceeds from any account periodically collected and that the same shall remain the sole property of the assignor, is in no way inconsistent with a security interest in appellant. It was solely to insure that the proceeds could be utilized by the debtor for its purposes until default —in other words, that the creditor could not proceed against the security until there was default.

With reference to the second new issue based upon the distinction between the bankrupt and the original debtor, the trustee incorporates his argument in his opening brief in Appeal No. 22507-A, *Everette H. Williams, Appellant,* v. *Rose City Development Company, Inc.,* and the trustee's argument is answered both in the appellee's brief and in the brief amicus curiae filed in that appeal. Appellant incorporates by reference the arguments in the answering briefs. In addition to the cases cited by appellee in No. 22507A, see *Eureka-Carlisle Company* v. *Rottman,* C.C.H. Bankruptcy Law Report § 62,866 — F.2d — (10th Cir., August 15, 1968) in which the following appears:

> "Eureka did not raise before the Referee or the District Court the issue whether it was entitled to a setoff, nor was the question considered or referred to, either directly or indirectly. In such circumstances, ordinarily an appellate court will not consider a question of law or fact which was not presented to, considered or decided by the trial court. This is well settled and the Tenth Circuit is in accord with the general rule established by many authorities. *Justheim Petroleum Co.* v. *Hammond,* 227 F.2d 629, 633 (10th Cir. 1955); and

Dubuque Fire & Marine Ins. Co. v. *Caylor*, 249 F.2d 162, 165 (10th Cir. 1957). . . ."

Independently thereof appellant wishes to note that Portland Reporter Publishing Company, Inc. did not cease to exist but was merely merged into the Portland Newspaper Publishing Company, Inc., that there was no sale and purchase of assets, nor any interruptions in the operations and the publication of the newspaper known as THE PORTLAND REPORTER—(there was an unrelated cessation of publication for a single day more than a month prior to the merger). The operations were continued under the commonly known name of the Portland Reporter and the newspaper continued to appear under that name.

The name of the merged corporation, the Portland Newspaper Publishing Company, Inc., the Bankrupt, was not generally known. Persons dealing with the enterprise dealt with it under the name of The Portland Reporter, the name of the newspaper. Creditors dealing with the Enterprise dealt with it by that name, and had inquiry been made by a creditor of the Corporation Commissioner as to the existence of financing statements the inquiry would, in all probability, have been made with reference to The Portland Reporter and not the Portland Newspaper Publishing Company, Inc. No creditor was or could have been misled. The case of *In re Excel Stores, Inc.*, 341 F.2d 961 (2 Cir. 1965), in which the Court held under the provisions of U.C.C. § 9-402(5) that the designa-

tion of the debtor in the financing statement as "Excel Department Stores" when its proper name was Excel Stores, Inc. was not too misleading, would seem to be decisive of this issue.

CONCLUSION

On the basis of the foregoing and appellant's opening brief, the Order of Judge Solomon should be reversed and the Court should direct that judgment be entered specifically recognizing the validity of appellant's security interest in the advertising accounts receivable specifically designated in the April 21, 1964 list and in all circulation accounts and the proceeds thereof.

Respectfully submitted,

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APPENDIX

The following was omitted from Appendix to Appellant's Opening Brief.

In further support of this contention see the following from *In re Bengston*, supra, at p. 289:

> "The agreement is defined in Section 42a-1-201(3) as the bargain between the parties 'as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in Section 42a-1-205 and Section 42a-2-208.'
>
> "The official comment as to Section 42a-1-205 headed 'Course of dealing and usage of trade' includes the following:
>
> > " 'This section makes it clear that; " '1) This act rejects both the "lay-dictionary' and the 'conveyancer's' reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.'
>
> "The Official Comment to Section 42a-2-208 headed: 'Course of performance of practical construction' recites in part:
>
> > " '1) The parties themselves know best what they have meant by their words of agreement and *their action under that agree-*

ment is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the 'agreement.'

"The conditional sales contract does not, in fact, comply technically with the provisions of Section 42-84(b)(8) which requires that the number of payments and the amount and date of each payment be set out. However, Section 42a-2-201 dealing with formal requirements states subsection (1) '. . . A writing is not insufficient because it omits or incorrectly states a term agreed upon. . . .' The only penalty provided in the statutes for failure to comply with the provisions of the Connecticut Retail Installment Sales Financing Act (Conn GS Section 42-83 thru Section 42-100) are those set out in Section 42-99 and Section 42-100, to wit: the nonrecovery of any finance, delinquency or penalty charge and/or the payment of a criminal fine. The contract is not otherwise void or voidable and as between the parties is enforceable, at least to the extent of a recovery of the selling price and the validity of security interest if it is otherwise properly perfected. This is emphasized by Section 42a-9-203 (2) which provides:

" 'A transaction, although subject to this article, is also subject to . . . Sections 42-83 to 42-97 inclusive and 42-99 . . . Failure to comply with any applicable statute has *only* the effect which is specified therein.' (emphasis added)

"Although the present unpaid balance on the Coca-Cola Bottling machine was not put in evi-

dence, *the parties unquestionably understood the terms of the agreement which at the time of bankruptcy had been in effect for approximately two years, during which time there was no apparent difficulty between the parties in interpreting their agreement.* (Underscoring supplied)

"Section 42a-2-208 provides:

" '1) Where the contract for sale involves repeated occasions for performance and opportunity for objection to it by the other, *any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.*

" '2) The express terms of the agreement and any such course of performance as well as any course of dealing and usage of trade, shall be construed whenever reasonable is consistent with each other.'

The comment on this section was quoted above.

"*Applying these criteria it is abundantly clear that the parties understood the agreement they made, they conducted themselves without objection under the agreement for a long period of time and a 'liberal construction of the act' applied to promote its underlying purposes and policies dictates that the security agreement be found valid as against the trustee.*" (Emphasis supplied)

Although Article 2 deals with Sales rather than Secured Transactions, the document involved in *In re Bengston* and construed by the Court in the light of the course of dealing and practice of the parties was a conditional sales contract and utilized as a security agreement. It is submitted that by analogy to the

foregoing and by a similar line of reasoning, the Davis agreement must be viewed in the light of the course of conduct followed pursuant to it and also to the DuBay agreement, with which it was in all material respects identical. When so viewed it must be construed as not requiring the execution of formal assignments but as being satisfied, insofar as effecting valid assignments, by the mere submission of schedules or lists of designated accounts receivable.

No. 22507-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Everette H. Williams,

Appellant,

vs.

Rose City Development Company, Inc.,

Appellee.

On Appeal From the United States District Court for the District of Oregon.

REPLY BRIEF OF APPELLANT.

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REPLY BRIEF OF APPELLANT.

I.

ROSE CITY'S SECURITY INTEREST WAS UNPERFECTED UNDER THE CODE ITSELF.

A. The Court Should Consider the Trustee's Argument in This Connection Despite the Failure to Urge the Point Below.

In the trustee's opening brief, we point out that Rose City had no written security agreement and no financing statement relating to its transactions with the bankrupt, as distinguished from transactions with the predecessor corporation. These deficiencies provide a further basis for holding the transfers in question to be preferential. Moreover, independently of the preference theory, the defect is fatal to Rose City's security interest under the Code itself and §§70a and c of the Bankruptcy Act.

Rose City's primary response to this argument is that it comes too late and cannot be considered by this court. There is, of course, a general rule that new issues should not be raised for the first time on appeal. But it is equally well-settled that the rule is not based upon a lack of power in the reviewing court, and in a number of situations exceptions have been made. For example, this court has previously stated that:

> "There is . . . no rigid and undeviating judicially declared practice under which courts of review invariably and under all circumstances decline to consider all questions which have not previously been specifically urged. Indeed there could not be without doing violence to the statutes which give federal appellate courts the power to modify, reverse or remand decisions 'as may be just under the circumstance.' 28 U.S.C.A. §2106. Exceptional cases or particular circumstances may prompt a reviewing court, where injustice might otherwise result or where public policy requires, to consider questions neither pressed nor passed upon below." *Neulsen v. Sorensen*, 293 F. 2d 454, 462 (9th Cir. 1961).

The principle which underlies the general rule against raising new points on appeal involves considerations of fairness. That is, litigants should have ample warning in the trial court of all issues upon which the matter is to be decided so that they may offer all the evidence they believe relevant. Where, as in the present case, the new contention involves solely a question of law on undisputed facts,[1] there has been no deprivation of the parties' opportunity to present evidence, and an exception to the general rule is especially justified. *E.g.*,

[1]It is conceded that Rose City obtained no new financing statement or security agreement and the details of the merger appear without dispute in the record.

Foster v. United States, 329 F.2d 717 (2nd Cir. 1964); *United States v. Merrill,* 211 F. 2d 297, 302-303 (9th Cir. 1954); *Cf., Leedom v. International Brotherhood of Elec. Wkrs.,* 278 F.2d 237, 244 (9th Cir. 1960).

Moreover, it would be less than fair under the circumstances of the present case to preclude the trustee on a technical ground from arguing a crucial legal issue. In support of Judge Solomon's decision, both Rose City and the Permanent Editorial Board For the Uniform Commercial Code, as amicus curiae (hereafter the "Board"), now rely primarily on the substitution of collateral doctrine. This theory was not asserted before the Referee. Indeed, there was no evidentiary basis for it until Exhibit 39 was stipulated to after the Referee's decision. Thus, Rose City should not be heard to complain about the trustee's raising a new point on appeal when it, or an amicus curiae in support of its position, actually raised a new point at the first appellate stage of this controversy.[2]

B. On the Merits, the Failure of Rose City to File a Financing Statement for Transactions With the Bankrupt and to Obtain a New Security Agreement After the Merger Was Fatal to the Security Interest in the Bankrupt's Accounts.

1. The Failure to File a Financing Statement.

In our opening brief, we contended that Rose City's security interest in the accounts of the bankrupt arising after the merger was unperfected under the Code itself, since no financing statement was signed by nor

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[2]As noted a Code proponent as Peter F. Coogan, Esq. of Boston, who contends that Rose City should prevail on the substitution of collateral theory, finds very little room to disagree with Referee Snedecor on the basis of the record before him. Advanced ALI-ABA Course of Study on Banking and Secured Transactions Under the Uniform Commercial Code, *Course of Study Transcript* 2 at 231 (1968).

filed with respect to the bankrupt as distinguished from the predecessor corporation (Op. Br. 17-20). Rose City and the Board respond that under §§9-403(2) and 9-306(2) of the Code a filed financing statement is effective for five years, and a security interest continues in collateral notwithstanding its transfer by the debtor. But this response is irrelevant to the present case. At most, application of the sections referred to means that Rose City's security interest in the accounts generated by the predecessor corporation would have continued perfected for five years even though they were transferred to the bankrupt in the merger. The question before this court, however, is not whether Rose City's rights continued in the transferred accounts. Rather, it is whether Rose City had a perfected security interest in the accounts generated after the merger by an entirely distinct legal entity.

The Board also points out that the official draft of the Code contains provisions (not adopted in Oregon) which permit the secured party alone to sign and file a financing statement where unilateral action of the debtor in changing his residence or moving or selling the collateral, will terminate the perfected status of the security interest. From this it is concluded that "if the debtor could similarly jeopardize the perfection by changing his or its name, the Code would have given the secured party the same protection" in the name change situations (Board Br. 10). Here, however, we do not have a situation involving a mere change of name by one debtor.[3] We have a change of debtors.

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[3]Even if only a name change were involved, the Board's argument is not persuasive. Provisions for filing by the secured party alone—*i.e.*, the single signature financing statement situations—are designed for the protection of a secured party whose existing security interest is threatened by the debtor's act. As to future security interests or security interests in future collateral, the secured party has the power before committing him-

For the purpose of the requirement of a new financing statement with respect to future transactions with a new debtor, the present case should be no different from any other where a buyer of a business assumes all the liabilities of the seller. No one would contend that in such event the secured party may rely on a financing statement of the seller to perfect a security interest in collateral acquired from other sources by the buyer after the sale.

It is true, as Rose City and the Board point out, that under §9-402(5) of the Code a financing statement is effective despite minor errors, provided they are not seriously misleading. But this section presupposes that there is on file some financing statement executed by the debtor. It does not purport to excuse a new filing where, as here, there is a change of debtor, even if the name and address of the new debtor were identical to those of the old. Moreover, this is certainly not a case where §9-402(5) would save Rose City in any event. The old financing statement relating to the predecessor corporation would indeed be seriously misleading insofar as transactions with the bankrupt were concerned.[4] A search of the public record for security interests in the assets of Portland Newspaper Publishing Co., Inc. would not give the notice of Rose City's claim as contemplated by Oregon's Uniform Commercial Code.

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self to insist upon the debtor's executing a new financing statement. The Board's point, therefore, if it is relevant at all, has validity only insofar as it relates to accounts in existence at the time of the merger. As to accounts thereafter generated, Rose City did not need a single signature provision; it could have demanded a new financing statement relating to those accounts before releasing any of the old collateral.

[4]The Board takes a very equivocable position on whether the "slight change of name" is seriously misleading. (Board Br. 11).

2. The Failure to Obtain a New Security Agreement.

Concededly the bankrupt never signed a security agreement relating to its accounts. Rose City and the Board nevertheless contend that the security agreement executed by the predecessor corporation taken together with the merger agreement signed by the bankrupt satisfy the requirements of §9-203(1)(b). We submit that this is too much of a relaxation of what the section demands. It is not difficult to comply with the simple formalities of the writing contemplated by the Code. To hold sufficient the generalized assumption of all liabilities and duties, as contained in the bankrupt's merger agreement, renders §9-203(1)(b) virtually meaningless. In the security agreement it signed, the predecessor corporation did not, indeed could not, undertake to grant a security interest in the assets of some other legal entity. And while the bankrupt may have agreed to take its predecessor's assets subject to the predecessor's debts and to pay those debts, the merger agreement in no way purported to secure those debts by property to be acquired by the bankrupt in the future.

In its brief the Board poses a hypothetical case where a construction business acquires a small architectural firm in a merger (Board Br. 8). We agree with the Board that "a security agreement covering the accounts receivable of the architectural firm would probably not pick up the accounts receivable arising, after the merger, out of the construction side of the business." (We submit, also, that the architectural firm's old security agreement would not pick up accounts generated by the construction firm, after the merger, arising out of its new architectural business).

We further agree with the Board that "under general merger principles, a security agreement covering construction machinery owned and to be acquired in the future by the construction company would be construed

to survive the merger and cover any such equipment acquired thereafter." But this is beside the point. We do not contend that the acquisition of new assets by a debtor—whether by merger, purchase, or by any other means—affects the validity of a previous security agreement made by that debtor.

The Board reaches the correct result in both instances because the surviving entity in its hypothetical case is the construction firm. But it erroneously suggests that the relative sizes of the merged and surviving corporations and the nature of their businesses bear on this result. Contrary to the Board, we submit that for present purposes it should not be important whether a smaller corporation merges into a larger one, or the larger merges into the smaller, or whether the two entities are in the same, related or different lines of business. To make distinctions regarding the requirement of a new security agreement based on these differences is both unworkable and not justified on policy grounds.[5] What should be and is crucial under the Code is that the debtor whose collateral is looked to has signed the requisite agreement.

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[5]Does the Board propose a rule to the effect that if the acquired company is large, security agreements signed by it which include after-acquired property clauses will also bind assets acquired by the surviving corporation in the future, but if the acquired company is small, the result is different? In such event, how is size to be measured—relatively, absolutely, by net worth, number of employees, value of assets, capital investment? Does it matter that in the Board's hypothetical case the acquiring business was engaged in construction whereas the acquired firm rendered architectural services? We note that the Board states only that a security agreement covering all "accounts receivable" would not cover future accounts arising "out of the construction side of the business." Would the Board propose that the old agreement could cover all of the future architectural accounts even if the surviving business substantially increased the size of its architectural department? How would the Board's rule apply to a receivable which results from a single billing by the construction firm for both architectural and construction services rendered in the planning and construction of a new building?

II.

THE SUBSTITUTION OF COLLATERAL DOCTRINE DOES NOT SAVE ROSE CITY'S SECURITY INTEREST FROM INVALIDATION AS A PREFERENCE.

In support of Judge Solomon's decision that the security interest was non-preferential, both Rose City and the Board now place primary reliance on the substitution of collateral theory. This was not the position taken before the Referee, and although the Board did argue it fully on review, Judge Solomon's ruling was based mainly on various other grounds.

Our opening brief analyzed the substitution doctrine and pointed out why it could not be applied on the present record (Op. Br. 44-47). One reason is that Exhibit 39 is the only evidentiary basis for application of the doctrine and it is insufficient for that purpose. The reply of Rose City and the Board in this connection is that the trustee carries the burden of proof as to all elements of a preference. But their argument is not responsive. As will be shown, the trustee need not, as part of his prima facie case, negate the doctrine's applicability.

There is no quarrel with the generalized statement that the trustee has the burden of proof—that is, the risk of persuasion—with respect to all elements of a voidable preference. We submit, however, that in Rose City's case the trustee at least carried his burden of producing evidence—that is, he made a prima facie case—when he established that the accounts in question arose after June 15, 1964, *i.e.*, during the four months' period, that the debt for which they were security was incurred in 1963, that the accounts in existence on June 15, 1964 were no longer in existence at bankruptcy, and that there was both insolvency and the element of reasonable cause to believe. At the end

of the trial, the Referee determined in effect that the trustee had carried the burden of proof as well as the burden of producing evidence; accordingly, he held against Rose City.

At this point in the case, the evidence now relied upon to support the substitution doctrine—Exhibit 39—had not been introduced, and there was no occasion to make findings of fact on that issue. Acceptance of the suggestion that the trustee did not carry his burden of proof logically leads to the result that the substitution theory should have saved Rose City even without Exhibit 39. Yet it is plain that on the record before him Referee Snedecor was correct in not requiring the trustee to negate the possibility of substitution of collateral. *Cf. Wolfe v. Bank of Anderson*, 283 F. 343 (4th Cir. 1916); see *San Mateo Feed & Fuel Co. v. Hayward,* 149 F.2d 875 (9th Cir. 1945).

It was only after the Referee's decision that Exhibit 39 was introduced. We can concede for the moment that once the creditor has gone forward with evidence of substitution of collateral, the trustee has the burden of persuasion with respect to whether or not the requisite conditions exist for application of the doctrine. But it was unnecessary for Judge Solomon to make any new findings of fact relevant to the substitution argument since he approached the case from a different standpoint;[6] accordingly, he did not consider whether the trus-

[6]The closest Judge Solomon came to making a finding relevant to the substitution issue was his observation that during the four months' period accounts totaling $397,860.24 were collected by the bankrupt and replacements were made totaling $395,085.87. We pointed out in our opening brief that the $397,860.24 figure derived from Exhibit 39 does not establish that this sum was actually collected; that is, the record does not indicate the extent to which the figure includes credit memos and write-offs (Op. Br. 45). More fundamentally, as we also demonstrated, the substitution doctrine cannot be

(This footnote is continued on the next page)

tee had, or met, the burden of proof in this connection. As a result, the most Rose City can ask for here is a remand for further findings of fact unless Exhibit 39 establishes to the satisfaction of this court, as a matter of law, that it would be impossible for the trustee to carry the burden of proof. Of course, the exhibit is far short of conclusive as was demonstrated in our opening brief (Op. Br. 45-47).

Finally, we submit that in most cases where substitution is urged the trustee, upon analysis, is not the one with the burden of proof on that issue. That is to say, the doctrine usually relates to a potential defense rather than to one of the affirmative elements of a preference. The doctrine requires that the replacement of new collateral must be either (1) simultaneous with or (2) precede the release of the old security (Op. Br. 44). In the first, less common situation, *i.e.,* the simultaneous exchange, present consideration is given and the antecedent element of a preference is lacking.

The analysis is somewhat different in the more common situation of the replacement preceding the release. It can be illustrated by this example: At the beginning of the four months period, a creditor holds valid collateral worth $10,000 to secure a $10,000 debt. Within the period the debtor transfers another $5,000 of collateral as additional security, and the secured party subsequently releases to the debtor $5,000 of the original collateral. Even assuming the existence of the various other elements of a preference and reasonable cause to believe, the substitution of collateral doctrine bars the trustee from avoiding the $5,000 transaction.

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applied by comparing aggregates of releases and replacements during the four months (Op. Br. 41-42); *Cf. Cooper Petroleum Company v. Hart*, 379 F.2d 777, 780-782 (5th Cir. 1967). Thus, the totals referred to by Judge Solomon are not relevant to the issue here under discussion.

This is true despite the fact that all the elements of a voidable preference exist. The result in this situation turns on §60c of the Bankruptcy Act, which in effect permits a creditor to offset against an otherwise recoverable preference any unsecured credit extended to the debtor after the preference.[7] Section 60c plainly relates to defensive matter rather than to the trustee's cause of action. When the substitution doctrine is invoked in this context, therefore, the burden of proof with respect to it is borne by the creditor.

III.
SECTION 9-108 OF THE CODE IS INAPPLICABLE BY ITS OWN TERMS.

In our opening brief, we argued that Rose City's security interest in the bankrupt's accounts failed to meet the "new value" requirement of §9-108 (Op. Br. 24-25). The Board, however, asserts that the release of collateral after the making of the security agreement and up to the beginning of the four months' period suffices to make §9-108 applicable (Board Br. 36). It is submitted that this is not a fair reading of the section. The value which is referred to as "new" must be given by the secured party at the inception of the transaction whereby the debtor grants a security interest in his after-acquired property—neither before nor afterwards. If this is not plain from the language of §9-108 itself, the official comment makes it so:

> "Two tests must be met under this section for an interest in after-acquired property to be one

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[7]Section 60c, 11 U.S.C. §96c:

> "If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him."

> not taken for an antecedent debt. First: the secured party must, *at the inception of the transaction*, have given new value in some form." UCC §9-108, official comment 1 (emphasis added).

In other words, §9-108 is not intended to be applicable unless the original granting of the security interest would have been non-preferential in a bankruptcy filed at that time. *Cf.* Hogan, *Games Lawyers Play With the Bankruptcy Preference Challenge to Accounts and Inventory Financing,* 53 CORNELL L. REV. 553, 569 (1968), *reprinted* at 1 COOGAN, HOGAN, VAGTS, SECURED TRANSACTIONS UNDER THE UCC §11.13[1] at 1212 (1968 ed.).

IV.
THE REFEREE'S DECISION DOES NOT IMPAIR OR INCREASE THE COST OF LEGITIMATE FINANCING OF RECEIVABLES.

The argument of the amicus curiae brief of National Commercial Finance Conference, Inc. is that if Rose City's security interest cannot withstand the preference challenge, flexibility in receivables financing will be impaired and financing charges to the small business borrower will be higher. The contention is unconvincing for at least two reasons. First, the financing of the bankrupt and its predecessor was far from a normal commercial transaction. There is no comparison between the manner in which Rose City handled its loans and what one would expect from a professional lender.[8]

Secondly, despite §9-108 and the abolition of the *Benedict v. Ratner* rule, we have been shown no evi-

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[8]Peter F. Coogan, Esq., has characterized the *Portland Newspaper* case as follows: ". . . this was a case where amateurs made all the mistakes that amateurs can make." Advanced ALI-ABA Course of Study on Banking and Secured Transactions Under The Uniform Commercial Code, *Course of Study Transcript* 2 at 230 (1968).

dence that the liberalizing provisions of Article 9 have in fact enabled the commercial finance and factoring industry to reduce its operating costs significantly. Even more is it to be doubted that the cost savings, if any, have been passed along to the small borrower. As was referred to in our opening brief, the practical problems are such that *Benedict v. Ratner* aside, some "policing" of the collateral remains necessary, and this is so regardless of the preference section (Op. Br. 49-50). Professor Gilmore explains:

> "Under §9-205, Article 9 repeals the rule of *Benedict v. Ratner* and any other lingering vestiges of *Twyne's Case*. A secured party is no longer required, as a matter of law, to 'police' his debtor's affairs on pain of having his security transaction treated, if he fails to meet the policing requirements, as a fraudulent conveyance. Nevertheless, the Code draftsmen recognized as sound the idea that a secured lender, particularly if he takes as security the inventory and receivables which are the most liquid assets of any enterprise, should, not only in his own interest but in the interest of other creditors, be under compulsion to pay close attention to the course of the debtor's affairs. We have suggested in another context why self-interest alone should be enough to insure that any lender who understands what he's dealing with will in fact observe the substance of the desirable patterns of financing which, in the area of receivables, developed in the wake of the *Benedict* case. If self-interest does not do the job, §9-306(4)(d) supplies the incentive. If a secured party, relying on the abolition of the *Benedict* rule, allows his debtor to make unrestricted use of proceeds and collections, paragraph (4)(d) puts beyond his reach, if insolvency proceedings occur,

everything except the last 10 days' receipts. To protect himself the secured party will have to require periodic accounting; if he does not pick up the proceeds at 10-day intervals, he will lose them irretrievably in the one contingency where he will ever need them—the institution of insolvency proceedings. In a word, to have the benefit of his security in the form of proceeds or collections, he will have to be the debtor's policeman, exactly as he had to be in the palmy days of *Benedict* theory."

II Gilmore, Security Interest in Personal Property, p. 1340 (1965).

V.

IF ROSE CITY'S SECURITY INTEREST IS UPHELD, THE CASE MUST BE REMANDED FOR FURTHER PROCEEDINGS.

We contended in our opening brief that a remand for further proceedings would be necessary if Rose City's security interest is upheld and the DuBay and Davis interests invalidated (Op. Br. 50-51). In such event two questions would remain unanswered, namely: May the trustee preserve the senior DuBay and Davis claims for the benefit of the estate? Did the parties intend to assign to Rose City the accounts meant for DuBay and Davis?

Rose City apparently misunderstood our position, for it asserts in response that "The trustee can only claim subrogation rights as the privy of Davis," and he cannot raise this point for the first time on appeal (Rose City Br. 9).

The trustee's attempt to preserve the DuBay and Davis security interests is not a new one. His pleadings before the Referee sought that relief but the point became moot when Rose City's security interest was

held invalid. It will be of importance again, however, if Judge Solomon's decision is affirmed in all respects.

The issue of whether Davis could compel Rose City to subordinate its claim to his, decided in the negative by Judge Solomon, is not the same as whether the trustee can preserve the Davis (or DuBay) security interest for the benefit of the estate. Rose City simply is incorrect in the statement that the trustee's claim is "as the privy of Davis." The trustee's ability to preserve is part of his avoiding powers under the Bankruptcy Act, see §60b, 11 U.S.C. §96b; §70e(2), 11 U.S.C. §110e(2), powers which Davis and DuBay themselves never possessed.

Finally, there remains an unresolved factual issue as to whether there was any intention to assign to Rose City the accounts designated for DuBay and Davis (Op. Br. 46, n. 15 and accompanying text). This is independent of the preservation or subrogation question. If, as the evidence seems to indicate, no such intent ever existed, Rose City could not claim the DuBay and Davis accounts under any circumstances.

Conclusion.

For the reasons set forth in Appellant's Opening Brief and in this Reply Brief, the order below should be reversed to the extent it upheld the validity of the alleged security interest of Rose City Development Company, Inc.

Respectfully submitted,

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United States Court of Appeals for the Ninth Circuit.

No. 22507-A.

EVERETTE H. WILLIAMS,
APPELLANT,

v.

ROSE CITY DEVELOPMENT COMPANY, INC.,
APPELLEE.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON.

BRIEF AMICUS CURIAE OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE.

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BRIEF AMICUS CURIAE OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE.

Preliminary Statement.

Pursuant to the procedure established by the Permanent Editorial Board for the Uniform Commercial Code, the Board submitted an amicus curiae Brief to the District Court at its request. All parties to this appeal have consented in writing to the submission of this Brief to the Court of Appeals, which consents have been submitted to the Court. This Brief was prepared by the Subcommittee on Construction of the Permanent Editorial Board and approved by that Board. It is being filed for the Permanent

Editorial Board by the Oregon Commissioners on Uniform State Laws.

Statement of the Case.

On October 19, 1964, the Portland Newspaper Publishing Co., Inc. (the "Bankrupt"), successor by merger to Portland Reporter Publishing Co., Inc. (the "Reporter"), was adjudicated a bankrupt upon an involuntary petition filed on October 15, 1964, and consented to by the stockholders and directors of the Bankrupt.

At issue are claims of three creditors asserting security interests in the net proceeds of accounts receivable collected by a representative of the secured creditors appointed on September 28, 1964, approximately three weeks before the bankruptcy.

The District Court's decision affirms the finding of the Referee to the effect that claims of two of these creditors, one of whom, Mr. DuBay, claims $25,000 with interest from September 16, 1964, and the other, Mr. Davis, claims $25,000 plus interest from September 18, 1964, are unsecured for the reason that in neither case was there an effectual assignment of the accounts claimed (R. 102, 104, 57).

The Permanent Editorial Board takes no position on the correctness of these findings but assumes them to be correct in discussing the findings and conclusions of the District Court and the Referee relating to the claim of Rose City Development Company, Inc. ("Rose City").

The claim of Rose City totals $53,122.26, with interest at 6½% per annum on $10,300 from November 22, 1963, and interest on the remainder at the same rate from September 11, 1964 (R. 7, 34, 95). It is based on two promissory notes issued in November of 1963, one dated November 16, 1963, and the other November 22, 1963, both of which are secured

by a security agreement signed by the Reporter, dated November 22, 1963, and titled "Accounts Receivable Loan and Security Agreement" (Ex. 17).

Under this security agreement—

1. Rose City acquired a security interest in all present and future accounts and contract rights, underlying goods and merchandise and the proceeds thereof, except certain accounts "heretofore assigned" to Mr. DuBay. Rose City's security interest in certain other accounts was later subordinated to a security interest that might be acquired therein by Mr. Davis (Ex. 15).

2. Outstanding loans were not to exceed "75% of the net value of qualified collateral" (defined to include only billed accounts), and any financial statement showing loans in excess of this percentage was to be followed by the furnishing of additional collateral or cash payment of the difference.

3. The Bankrupt was permitted to collect and in practice to use the proceeds of the accounts with the reserved right in Rose City to take over collections at any time, a right which it exercised for a short period in February of 1964, as well as on September 28, 1964.

A financing statement signed by the Reporter was duly filed November 26, 1963, describing the collateral as "Accounts Receivable" but without check of the "Proceeds" box (Ex. 3).

On March 27, 1964, the Reporter and the newly organized Bankrupt, both being Oregon corporations, signed a merger agreement which provided that the Bankrupt would succeed to and possess "all of the rights, privileges, powers and immunities of the Reporter" and would be subject to "the liabilities and duties of the Reporter" (Ex. 19).

From June 15, the beginning of the four-month period prior to the bankruptcy, and up to September 28, when col-

lection of the accounts was taken over by a representative of the secured creditors, the balance of billed accounts never went below the low of $129,482.50 on June 27. The balance stood at $144,255.70 on June 15, and at $141,463.48 when the representative undertook collections on September 28 (Ex. 39).

Additional billings of $71,061.90 were made thereafter, $25,939.75 of which represented accounts resulting from the sale of advertising, the remainder being circulation accounts, or accounts resulting from the sale of newspapers (Ex. 39). The Bankrupt suspended publication on September 30. The collections of the representative of the secured creditors totalled $126,829, of which $107,000 was left after deducting the costs of collection (R. 6, 91).

The amounts which the secured creditors permitted the Bankrupt to collect and use in the same period (June 15 to September 28) and the billings by the Bankrupt during the same period are shown on a bi-weekly basis in the table set out on page 41 of the Appendix, with a column reflecting the effect of such collections and new billings on the balance of unpaid billings. From this table, which is derived from Exhibit 39, it can be seen, and Judge Solomon found (R. 100), that the Bankrupt collected and used $397,860.24 worth of accounts which were subject to Rose City's security interest, which collections were presumably used to pay wages and other current operating expenses of the Bankrupt. During this same period the collateral was replaced with a slightly lower volume of billings.

The Referee concluded that Rose City's security interest in the replacement accounts was voidable as a preference under Section 60 of the Bankruptcy Act, 11 U.S.C. § 96 (R. 58, 59). Both he and the Trustee suggested, however, that if Rose City had exercised dominion over the collateral in the manner required by the law of Oregon before the en-

actment of the Uniform Commercial Code, there would have been no preference (R. 98). The District Court properly concluded that there was no preference on at least three separate grounds, *any one of which* is sufficient to support the conclusion. These three grounds involve the three principal questions raised by the foregoing facts, each of which was answered in the affirmative by the District Court.

Questions Presented.

1. Where, within four months of the bankruptcy of the debtor, Rose City (*a*) releases to the debtor the proceeds of accounts receivable in which Rose City has a valid and perfected security interest, (*b*) does so contemporaneously with or subsequent to the creation of new acccounts receivable which are subject to Rose City's security interest, but (*c*) does not take possession of or exercise "dominion" over the proceeds before they are released, is the release of proceeds and the creation of the new accounts a substitution of collateral so that the interest of Rose City in the new accounts cannot be preferential under Section 60 of the Bankruptcy Act?

2. If the transfer of such accounts is deemed to have taken place during the four-month period, are the accounts which arise in the ordinary course of the business of the debtor taken for new value and not as security for an antecedent debt as provided in Section 9-108 of the Code (O.R.S. § 79.1080)? [1]

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[1] Code section numbers conform to sections of the Oregon Revised Statutes if the dash is changed to a decimal point and the number is expanded by adding the digit 7 at the beginning and the digit 0 at the end.

3. Where almost a year before bankruptcy of the debtor (*a*) Rose City makes a loan to the debtor, (*b*) the debtor grants Rose City a security interest in its then existing and future accounts receivable, and (*c*) a financing statement is publicly filed under the Uniform Commercial Code, does the transfer of those accounts receivable which are generated by the debtor during the four-month period prior to its bankruptcy take place before the four-month period for the purposes of applying Section 60 of the Bankruptcy Act?

Argument.

I. The Effect of the Merger of Portland Newspaper Publishing Co., Inc., and Portland Reporter Publishing Co., Inc.

The Permanent Editorial Board's concern with this case and its importance to secured financing throughout the country has centered on issues raised by the interaction of the Uniform Commercial Code and Section 60 of the Bankruptcy Act, 11 U.S.C. § 96, when an obligation is secured by a changing pool of collateral. These issues were central to the decisions of the District Court and of the Referee, and were considered at length in both forums. Before getting to them, however, we feel obliged to comment on new and quite different issues which are raised in the Trustee's Brief for the first time and without the benefit of any consideration below.

The Trustee now argues that the merger of the Reporter and the Bankrupt invalidated Rose City's security interest in the accounts receivable which arose after the merger, and that, even if valid, such interest was unperfected because no new financing statement was filed show-

ing "Portland Newspaper Publishing Co., Inc.," as the secured party and signed in that name (Trustee's Brief, 17-20).

The argument as to validity has two parts, both of which would seem to be disposed of by the merger agreement (Ex. 19). The first part of the argument is that with respect to those accounts which arose after the merger, the requirements of Article 9's Statute of Frauds, set out in Section 9-203(1) of the Code (O.R.S. § 79.2030(1)), were not met, since the security agreement between the Reporter and Rose City was not specifically re-executed in the name of Portland Newspaper Publishing Co., Inc. Comment 5 to Section 9-203 states that more harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing. American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 641-642. The merger agreement between the Reporter and the Bankrupt was a signed writing, and, in view of its provisions that the Bankrupt would succeed to the Reporter's rights, privileges and immunities, and would be subject to the Reporter's liabilities and duties, the Bankrupt's signature thereon authenticated the security agreement as much as if it had been written on the security agreement itself. See Section 1-201(39) (O.R.S. § 71-2010(39)).

The second part of the argument is that the description of the collateral in the security agreement was not broad enough to cover accounts generated by the surviving corporation. This involves the effect on an existing financing arrangement of a change or modification of the make-up of one of the parties to the arrangement. Such a change can occur in a variety of ways. A new partner joins an

existing partnership. An old partner retires. A small corporation merges or consolidates with a large corporation. A corporation makes extensive modifications of its articles of incorporation, including substantial changes in control, classes of stock, and, perhaps, its purposes.

Article 9 of the Code leaves the law regarding the effect of modifications or changes of make-up to general law and to the courts. The results, of course, depend both upon the nature of the problem and upon the nature of the change or modification. Here the problem is to determine what property is covered by the after-acquired-property clause in the security agreement signed originally by the Reporter and adopted by the Bankrupt.

One example of a change of make-up might involve a large corporation in the construction business which merges with a small architectural firm. In such a case a security agreement covering the accounts receivable of the architectural firm would probably not pick up the accounts receivable arising, after the merger, out of the construction side of the business. On the other hand, the Board assumes that, under general merger principles, a security agreement covering construction machinery owned and to be acquired in the future by the construction company would be construed to survive the merger and cover any such equipment acquired thereafter. Any other holding would substantially complicate the many situations where slight changes of make-up occur and would place an additional burden on secured parties which, even if shouldered, would result in no particular benefit to the other creditors.

The application of the after-acquired-property clause in the security agreement before this Court creates no ambiguity, since the purpose of the merger of the Reporter and the Bankrupt was merely to carry out a refinancing and change of control of the publishing company. The

accounts receivable generated after the merger were the same accounts as would have been generated if the refinancing had been accomplished without a merger. There would have been a different problem if there had been a merger of two operating newspapers into a single newspaper. But this was not the case. Prior to the merger, Portland Reporter Publishing Co., Inc., was publishing and selling the Portland Reporter. After the merger, Portland Newspaper Publishing Co., Inc., was publishing and selling the Portland Reporter.

The issue raised by the Trustee with respect to the financing statement is an important one and could be decided in a way which would seriously undercut the objectives of the draftsmen of the Uniform Commercial Code to simplify and rationalize security transactions. The financing statement issue has two parts, which should first be considered separately. One is the change of name, and the other is the change of make-up.

Although Part 4 of Article 9 of the Code contains no specific provisions on the subject, it contemplates that a financing statement which is properly filed continues effective even though one of the parties thereto changes its name. This conclusion is supported by a literal reading of Section 9-403(2) (O.R.S. § 79.4030(2)), which provides:

> "A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financing statement is effective for a period of five years from the date of filing.

Further support for this conclusion is found in Section 9-402(2) (O.R.S. § 79.4020(2)) and in the alternative form of Section 9-401(3) offered in the official draft, but not

adopted by the Oregon Legislature (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 699). Both of these provisions deal with situations where some action of the debtor, such as changing his residence, moving the collateral or selling the collateral, will terminate the perfected status of the secured party's security interest in the collateral. Both of these provisions recognize that, under these circumstances, it may be impossible for the secured party to obtain the debtor's signature on the new financing statement required to maintain perfection, and both therefore permit the secured party to file a financing statement signed only by the secured party. If the debtor could similarly jeopardize the perfection by changing his or its name, the Code would have given the secured party the same protection.

We come to a similar conclusion concerning the effect which the change of make-up would have had on the financing statement if there had been no change of name. The financing statement would continue to be effective. As between the parties, the merger agreement and the merger statutes would seem to eliminate any requirement of a new financing statement. From the point of view of third parties examining the records, the execution of a new financing statement by a successor corporation of the same name and address would seem to have no effect except to start the five-year period running again.

In the case before this Court, involving, as it does, only a slight change in the name and a modification only of the control and financing of what is essentially the same business, we see no reason why the result should be any different. If the Court should disagree, however, and decide to apply a more stringent test, it should look to the rule set out in Section 9-402(5) (O.R.S. § 79.4020(5)) with regard to errors or variations in the original financing state-

ment. It is there provided that a financing statement is effective if it substantially complies with the requirements of Section 9-402, even though it contains minor errors which are not seriously misleading.

Comment 5 to Section 9-402 states that the subsection is designed to reverse *General Motors Acceptance Corporation* v. *Haley,* 329 Mass. 559, 109 N.E. 2d 143 (1952), in which a statement of trust receipt financing was held invalid when made in the name of "E. R. Millen Company" when the Trustee was actually "E. R. Millen Co., Inc." (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 704). The Court of Appeals was clearly influenced by this Comment when in *In re Excel Stores, Inc.,* 341 F. 2d 961 (2d Cir. 1965), it held that a financing statement showing the debtor as "Excel Department Stores" was not seriously misleading, although the debtor's correct name was "Excel Stores, Inc."

While the Board has not examined, the complete record in this case on the issue of whether or not the slight change of name would be regarded as seriously misleading, it notes again that the Reporter and the Bankrupt were carrying on essentially the same business, were both publishing the Portland Reporter and were apparently sufficiently identical in both name and business that nobody thought to raise these issues either before Judge Solomon or before the Referee. If this Court decides to consider the issues now raised by the Trustee, it would seem that there is ample basis for rejecting the Trustee's contentions.

II. The General Rationale of the Uniform Commercial Code in Relation to the Bankruptcy Act.

Both secured and unsecured credit are essential parts of the American economy. In a few situations and at certain

times their interests conflict. In infinitely more situations and times their functions are complementary or parallel, with no conflict but rather mutual benefit to each other and to those extending or utilizing each type of credit.

The present case involves a dispute between secured and general creditors. It also involves a dispute between what might be called "financing creditors" and "merchant creditors." The first group is made up primarily of banks, finance companies, life-insurance companies and other institutional lenders. The second group is made up primarily of creditors extending credit by the sale of goods and services, frequently called "trade creditors."

Suppliers of goods and services or merchant creditors (including wage claimants) received their full share of the money made available to business entities through financing credit because, obviously, financing credit used by the average business entity will, in turn, be used to make payments to its suppliers of goods and labor as well as for other purposes.[2]

Long before the drafting, promulgation and enactment of the Uniform Commercial Code it was possible for a debtor to give and a creditor to receive security in personal property in substantially all of the ways that are available under Article 9 of the Code. However, where these various security devices all developed at different times in history; were created to meet different needs; were evidenced by different forms of agreement; and public notice of them was given in different ways—there were many problems and many technical and formal requirements, turning not on the function of the financing but on its form, with resultant confusion and traps for the unwary. The net

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[2] In the fourth quarter of 1965 manufacturing corporations were furnished 33 billion dollars of merchant credit and 61 billion dollars of financing credit. See FTC-SEC, Quarterly Financial Report for Manufacturing Corporations, Fourth Quarter, 1965, at 34.

result of this was that secured credit was needlessly complex in execution and costly to the borrower beyond any requirement of fairness to the general or merchant creditors.

The issue for the draftsmen of the Uniform Commercial Code, therefore, became one of simplification and cheapening of this type of credit without injury to the legitimate interests of unsecured creditors. These interests rest primarily on the elimination of secrecy and on the non-monopolization of a debtor's assets by a secured lender. The provisions of Article 9 of the Code require notice of the existence of a security interest to be given either by possession or by filing, with a few exceptions not relevant here. As a result, general creditors or merchant creditors can ascertain at any time whether or not a prospective debtor has given security to any other person. In many cases the general creditor will be glad this security has been given because of the increased financial strength implied by it. But, whether he is or is not pleased, if the general creditor elects to extend credit, he does so with his eyes open.

The Code is entirely fair in provisions as to who may obtain security. Under the Uniform Trust Receipts Act and under Factors Lien Acts this type of security was available only to financing creditors. But under the Code security of exactly the same type may be obtained by merchant creditors, and these creditors, if they elect to follow the simple rules of the Code as to purchase-money security interests, may even obtain priority over a financing lender. Other built-in deterrents to monopolization of a debtor's assets include the provisions of Section 9-208 (O.R.S. § 79.2080) requiring a secured party to confirm or disclose the amount of the debt and collateral, thus permitting the debtor or a competing financer to pay off the debt and ef-

fect a release of the collateral; the possibility of subordination (as the Bankrupt obtained from the general financer, Rose City, in favor of Davis in this case), Section 9-316 (O.R.S. § 79.3160); and the simple power of a debtor to limit the security of any secured party. Actual experience in operations under the Code clearly establishes that earlier fears of monopolization of assets by a single secured financer simply have not been substantiated.

In the type of financing represented by this case, the Code requires that notice of the financing be given to all the world, as was done, not only by Rose City, but also by Mr. Davis and Mr. DuBay. Further, Section 9-108 (O.R.S. § 79.1080), in conferring new value as distinguished from antecedent-debt status on after-acquired property collateral, is careful to limit this result to cases where the debtor acquires his rights in the ordinary course of business.

The policy of the Uniform Commercial Code toward the simplification of secured credit is entirely consistent and not in conflict with the basic principles of Section 60 of the Bankruptcy Act. Section 60 is pointed primarily at the potential of one creditor acquiring shortly before bankruptcy by aggressive tactics more than his fair share of an insolvent estate. It is also aimed at secret liens of a type for which local law requires some form of public notice. To achieve these objectives it establishes an arbitrary four-month period prior to bankruptcy during which certain acts by any creditor of the Bankrupt, whether secured or unsecured, which acts are done with knowledge or reason to know of the debtor's insolvency and which acts improve the creditor's position with respect to other creditors, can be avoided by the Trustee in Bankruptcy. Congress has established an elaborate set of rules for application of these objectives which are themselves quite complicated and each of which has its own growing body of law. These rules are designed to determine whether an act oc-

curs prior to the four-month period or during the four-month period, and, when it is found to occur during the four-month period, to determine whether the act is of the aggressive nature which should be prohibited.

In the application of these technical rules, some of which were written without anticipation of modern security law, sight should not be lost of the underlying objectives.[3] On the particular facts of this case, no aspect of Rose City's security interest in the accounts receivable conflicts with those underlying objectives. It is the purpose of this Brief to show that this security interest is entirely consistent not only with the objectives but also with the more detailed rules of Section 60.

III. Rose City's Security Interest in the Receivables Outstanding on September 28 was Not Preferential, since Most of the September 28 Receivables were Substituted for Those Outstanding at the Beginning of the Four-Month Period.

A. The Substitution-of-Collateral Doctrine.

The burden of proving all six elements of a preference is upon the Trustee. *Keenan Pipe & Supply Co.* v. *Shields,* 241 F. 2d 486 (9th Cir. 1956). *Barry* v. *Crancer,* 192 F. 2d 939 (8th Cir. 1951). See *Miller* v. *Fisk Tire Co.,* 11 F. 2d 301, 304 (D. Minn. 1926), and *Pasadena Investment Co.* v. *Pasadena Air Products, Inc.,* 234 F. Supp. 128, 134 (S.D. Cal. 1964). These elements are set out in paragraph (1) of Section 60a as follows:

> "A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit

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[3] Compare *Bank of Marin* v. *England,* 385 U.S. 99 (1966), in which the Supreme Court declined to apply Section 70d of the Bankruptcy Act literally.

> of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.''

The foregoing language is drawn in substance from Section 60 of the Act of 1898, 30 Stat. 562. It was early held under Section 60 that a transfer made by an insolvent debtor within four months of the debtor's bankruptcy is not a preference where the transfer is made for new and substantially contemporaneous consideration. *Dean* v. *Davis,* 242 U.S. 438 (1917). Both the rationale for this holding and the many cases which support it are set out in 3 Collier on Bankruptcy, 846-888 (14th ed. 1967). The pages cited discuss the antecedent-debt requirement, which is categorized as the third element of a preference, and assert that Section 60 avoids only those transfers which result in a depletion or diminution of the Bankrupt's estate available for creditors.

The diminution rule articulated, for example, in *Bachner* v. *Robinson,* 107 F. 2d 513, 514 (2d Cir. 1939), and *In re Loring,* 30 F. Supp. 758, 759 (D. Mass. 1939), can be justified under paragraph (1) on the theories that, if a transfer does not deplete the estate available for creditors, either it is made for contemporary consideration and is therefore not made ''for or on account of an antecedent debt'' or it does not ''enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.''[4]

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[4] Two provisions of Section 60 covering special situations support the general principle of the diminution rule. One is the

A corollary to the diminution rule is the rule, also early recognized in bankruptcy law, permitting the exchange, substitution or renewal of security. In *Sawyer* v. *Turpin,* 91 U.S. 114, 120-121 (1875), for example, the Supreme Court said:

> "It is too well settled to require discussion, that an exchange of securities within the four months is not a fraudulent preference within the meaning of the Bankruptcy Law, even when the creditor and the debtor know that the latter is insolvent, if the security given up is a valid one when the exchange is made, and if it be undoubtedly of equal value with the security substituted for it."

B. There is No Preference where New Accounts are Substituted for Proceeds of Collected Accounts Released to the Debtor.

The foregoing principles were applied to accounts-receivable financing in *In re Pusey, Maynes, Breish Co.,* 122 F. 2d 606 (3d Cir. 1941), affirming 37 F. Supp. 316 (E.D. Pa. 1941). In that case Judge Goodrich, for a unanimous court, upheld the security interest of the Philadelphia National Bank in accounts receivable assigned to it during the four months prior to bankruptcy as security for indebtedness of $20,000 incurred prior to the four-month period.

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language in paragraph (8) of subdivision *a* covering transfers where neither filing, recording nor delivery is required for perfection against lien creditors under local law, which provides that a transfer for new and contemporaneous consideration or for a future loan actually made is deemed to take place on the date of the transfer. The other is subdivision *c* of Section 60, which provides that a creditor who receives a preferential transfer and later makes an *unsecured* loan to the Bankrupt may set off the unpaid portion of the loan against the amount receivable by the Trustee on account of the preference.

Under the arrangement between the debtor and the bank the accounts receivable which were from time to time assigned to the bank during the year prior to the bankruptcy were collected by the debtor and deposited in a special account with the bank from which the debtor could make withdrawals only with the consent of the bank. Proceeds of cash sales made by the debtor were also deposited in this account. The agreement provided that, if the debtor had new accounts which were satisfactory to the bank as security, it could offer them to the bank in substitution for the release of the moneys on deposit. The face amount of the accounts receivable at the inception of the arrangement was $21,995.25. It was agreed that from the inception of the arrangement it was the "practice" of the bank to require that the net amount of the assigned accounts receivable plus the balance of the special account should at all times aggregate $25,000 before permitting any withdrawals by the debtor from the account. Four months before bankruptcy the aggregate was $24,640.10, and on the date of bankruptcy it was $25,368.41, of which $4,854.01 was on deposit in the special account and $20,514.40 was the face amount of assigned accounts. Of these accounts all but $427.63 worth had been assigned to the bank during the four months immediately preceding the filing of the bankruptcy petition.

The Referee in Bankruptcy concluded that the substitution of collateral, not being made simultaneously with and in equal amounts to the release of cash by the bank to the debtor from the special account, constituted a fraud on creditors within the rule of *Benedict* v. *Ratner,* 268 U.S. 353 (1925). Judge Goodrich found that the law of Pennsylvania included the rule of *Benedict* v. *Ratner* and that therefore, under Pennsylvania law, an assignment of accounts receivable would be deemed fraudulent as to the

rights of creditors if the assignor had control over the accounts to the extent that he was free to use the proceeds of the accounts for his own purposes. He held, however, that the arrangement between the bank and the debtor did not violate the rule.

More important, however, he held that there was no basis for invalidating the bank's security interest in the accounts under Section 60. Counsel for the Trustee cited cases for the proposition that the substitution-of-collateral doctrine could not be applied unless the transfer of the new collateral and withdrawal of the old collateral took place simultaneously. As the Court pointed out, however, all of the cases cited involved "substitution" where the old item of collateral was released a substantial period of time *before* the new collateral was transferred. Judge Goodrich indicated that, once the new collateral had been acquired, it was immaterial whether the old collateral was released simultaneously or subsequently. He reasoned that to hold otherwise would invalidate mortgages for future advances.

Counsel for the Trustee also argued that, to the extent the new security had a higher value than the old security, the bank's security interest was preferential. While conceding that this might be the correct rule, Judge Goodrich held that the Court did not have possession of sufficient facts to determine that there was such a difference in value, and that it therefore had no basis for invalidating any part of the assigned assets in the bank's hands.

C. Rose City's Security Interest Meets the Most Stringent Requirements of the Substitution-of-Collateral Doctrine.

Relying to a considerable extent on an early Circuit Court of Appeals case, *Wolfe* v. *Bank of Anderson,* 238 F. 343 (4th Cir. 1916), the Trustee argues that two rules must be strictly applied in determining whether transfers dur-

ing the four-month period are to be considered substitutions of collateral. The first is that the new collateral must be transferred to the secured party either prior to or contemporaneously with the release of the old collateral. The second is that, if the new collateral is of greater value than the collateral which is released, a voidable preference for the difference in value may result (see Trustee's Brief, 41).

From these two rules it is possible to derive a third rule as follows:

> Where a changing pool of collateral secures fixed indebtedness during the four-month period prior to bankruptcy, the collateral in which the secured party has a security interest on the date of bankruptcy is subject to attack on grounds of preference to the extent that its value on the date of bankruptcy exceeds the lowest value of the collateral pool during the four months prior to the bankruptcy of the debtor.

The derivation of the third rule from the two rules advocated by the Trustee is discussed at greater length in the Appendix to this Brief. For convenience, we will refer to it as the *strict test,* and will later argue in this Brief that there are more suitable tests for use in determining whether or not a security interest in a changing pool of collateral meets both the objectives and the technical requirements of Section 60.

Based on the facts and assumptions stated at the beginning of this Brief, however, there can be no question that Rose City's security interest in the accounts collected by the Trustee meets the *strict test.* The minimum balance of *billed* accounts from the beginning of the four-month period until September 28, the date on which Rose City began to collect the accounts through its Trustee, was

$129,000, an amount which was more than twice the claim of Rose City. During that same period collections released to the Bankrupt totalled $397,860.24, while new billings totalled $395,085.87.[5]

On these facts and figures it could hardly be clearer that the Trustee has failed to sustain his burden of proving that the Bankrupt's estate was diminished during the four-month period.

D. The Rule of Benedict v. Ratner is a Matter of State, Not Federal, Law.

The case before this Court differs from the *Pusey* case in two respects, neither of which changes the result. The first difference is the fact that it was unnecessary for the Bankrupt to make new assignments of its accounts each time new accounts were generated, since under Sections 9-204, 9-302 and 9-402 of the Uniform Commercial Code

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[5] See the chart on page 41 of the Appendix. More than $55,000 was collected from the $141,000 of billed accounts outstanding on September 28, since $126,829 was collected by the representative of the secured creditors and $71,061.90 was billed after September 28, all of which was probably not collected. It is therefore unnecessary at this point in the argument to consider Rose City's interest in the accounts billed after that date. For a discussion of such interest see Part IV, A, pp. 26-27.

The Trustee argues that, even if the transfers to Davis and DuBay are invalid, it is not clear that "those accounts" were assigned to Rose City (Trustee's Brief, 46). This argument has no validity as to Mr. Davis, since the security agreement contains no limitation whatsoever with respect to accounts purportedly assigned to him. The subordination agreement with Mr. Davis subordinates Rose City's interest only to those accounts which are in fact acquired by Mr. Davis (Ex. 15). Rose City's security agreement does except from its coverage accounts "heretofore assigned" to Mr. DuBay (Ex. 17). If the Court holds that none of the accounts in question were assigned to DuBay, however, then none of them fall within the exception.

(O.R.S. §§ 79.2040, 79.3020 and 79.4020) an assignment of present and future accounts accompanied by the proper filing of a financing statement was all that was required to obtain a valid and perfected lien in the new accounts as they arose. This is a matter upon which state law supplies the conclusive answer. See *Mason* v. *Citizens' Nat. Trust & Savings Bank,* 71 F. 2d 246, 248 (9th Cir. 1934), and 3 Collier on Bankruptcy, 957-961 (14th ed. 1967).

The second difference is the fact that, although the debtor collected the accounts in this case and in the *Pusey* case, and although in both cases the secured party had the right to prevent the debtor from utilizing the proceeds for its own purposes, in the *Pusey* case the debtor was not allowed to utilize them until they had first been deposited in a special account, a procedure required under the law of Pennsylvania by the rule of *Benedict* v. *Ratner.* In the case before this Court the debtor was permitted to use the proceeds until Rose City asserted its right to them, which it did assert at two different times.[6]

Under Section 9-205 of the Code (O.R.S. § 79.2050) the dominion rule of *Benedict* v. *Ratner* is no longer part of the law of Oregon. In enunciating the rule in the case for which it is named, Justice Brandeis made it clear that he was talking about state rather than federal law (268 U.S. 353, 360

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[6] The failure to check "Proceeds" in the financing statement filed by Rose City is irrelevant under the facts of this case, since the proceeds at issue were collected by a representative of the secured creditors and never came into the possession of the debtor. Undr Section 9-306(3) of the Code (O.R.S. § 79.3060(3)), even though proceeds are not claimed in the financing statement, the security interest in them is continuously perfected until ten days after "receipt of the proceeds by the debtor." If proceeds had been claimed by Rose City in the financing statement, it would have had a claim against any identifiable proceeds in the possession of the Bankrupt, a claim which probably would have been of little value.

(1925)), and in *Petition of Post,* 17 F. 2d 555 (1st Cir. 1927), cert. den. 275 U.S. 527 (1927), it has since been held that the rule is not one of federal law. The Referee's opinion in the case before the Court indicates otherwise by suggesting that a preference might have been avoided by having the proceeds flow through a cash-collateral account (R. 36).

The Trustee's Brief seems to distinguish the case before this Court from *Pusey* solely on the basis that Rose City failed to police the collections by the debtor. The distinction, however, seems to be an evidentiary one. He says on page 44 of his Brief:

> "A secured party who fails to police his collateral probably will be unable to demonstrate that the releases of collateral occurred at the requisite points in time."

This assertion, of course, overlooks the fact that the burden of proving all elements of a preference is on the Trustee (see cases cited on page 15 hereof). In fact, the Trustee in *Pusey* made an analogous argument when he claimed that the value of the security had gone up during the four-month period. The Court, however, said that there was not sufficient evidence to determine the question, despite the fact that the dollar total of the cash-collateral account and the face amount of the uncollected accounts was somewhat higher on the date of bankruptcy than it was at the beginning of the four-month period. A similar argument advanced by the Trustee in *Rosenberg* v. *Rudnick,* 262 F. Supp. 635, 640 (D. Mass. 1967), was rejected on the same basis.

Regardless of the burden of proof, it can well be asked whether the policing of the collateral in *Pusey* would, if the Court had adopted the *strict test* advocated by the Trustee, have made it any easier to apply that test. Its

application would have required determining the lowest value of the collateral during the four-month period. It seems perfectly obvious that the determination of the value of the assigned accounts at any moment in time would have been equally difficult whether proceeds of the accounts later flowed through a cash-collateral account or through the debtor's regular bank account.

The Trustee stresses the fact that Exhibit 39 fails to show account balances at various times during any given day. This objection itself indicates the absurdity of the *strict test*. The Trustee also urges that Exhibit 39 fails to reflect the real value of the collateral as distinguished from its book value (Trustee's Brief, 46, 47). It should be pointed out that neither of these objections is affected in any way by, or has anything to do with, whether the secured party requires that the proceeds of the accounts be run through a cash-collateral account. Both of them are equally applicable to the fact situation in *Pusey* and therefore are no basis for distinguishing *Pusey*.

With the development and general adoption of modern accounting principles and methods which enable simpler and yet reliable procedures for checking collateral and with the repeal of the rule of *Benedict* v. *Ratner*, many lenders making term loans secured by a changing pool of collateral have, in appropriate situations, dispensed with the expense and trouble of requiring that proceeds of the pool flow to the lender and back to the borrower through a loan account or a cash-collateral account. In this type of loan, where a financing statement has been filed giving public notice of the lender's security interest in the collateral, pouring the funds through a special account instead of releasing them directly to the borrower gives no additional protection to the unsecured creditor. In fact, by lengthening the pipeline through which the proceeds flow, it may increase the percentage of the debtor's assets subject to the security

interest of the secured lender, and, by substantially increasing the cost of the secured credit, may make the borrower's financial situation more precarious, thus having an adverse effect on the position of the unsecured creditor.

By enacting Section 9-205 of the Code and repealing or confirming the inapplicability of the rule of *Benedict* v. *Ratner,* the Legislatures of forty-nine states and the United States Congress, for the District of Columbia, are saying that, if public notice of the existence of a security interest is given by the filing procedures of the Uniform Commercial Code, exercise of dominion under the principles of *Benedict* v. *Ratner* is no longer important. There is nothing in the policy or language of Section 60 which frustrates this repeal. In the words of the District Court (R. 99), "Good business practice should be good business law."

IV. Rose City's Security Interest in the Receivables Outstanding on September 28 was Not Preferential since All the Receivables Subject to the Security Interest Arose in the Ordinary Course of the Debtor's Business.

A. Precise Application of a "Strict" Substitution-of-Collateral Rule is Impractical.

This Brief could stop here except for the fact that the Court might decide to uphold the prior claims of Messrs. DuBay and Davis. In that event the question of whether the value of the collateral in which Rose City had its security interest on the date of bankruptcy exceeded the lowest value of the collateral in which Rose City had an interest during the four-month period prior to bankruptcy becomes a much closer one. Here again, however, it is perfectly clear that the Trustee has failed to sustain the burden of proof.

In order to have sustained that burden, the Trustee, if he is to insist on the *strict test,* should have offered evidence to prove that at some point during the four-month period the value of Rose City's collateral dropped below the amount of its claim. The evidence offered to establish the value of the collateral at such point in time (1) should show the value of the then unbilled accounts, (2) should show the true value as opposed to the book value of the accounts outstanding at the time, and (3) should include the value of accounts arising subsequent to the date of valuation out of any contract rights in which Rose City then had a perfected security interest.

The first of these requirements is based on the fact that on any particular day the collateral included not only the billed accounts, which would be reflected in the daily balances appearing in Exhibit 39, but also the unbilled accounts. Section 9-106 of the Code (O.R.S. § 79.1060) provides that an "account" is a right to payment for goods sold or services rendered. There is no requirement that it be billed. The official comment to this Section states that the right to payment is "a right earned by performance, *whether or not due and payable*" (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 627). (Italics supplied.)

The adjustment in the total value of the collateral made on account of unbilled accounts would be particularly significant in the case of the monthly circulation accounts earned by delivery of newspapers during the month, half of which would be earned by the fifteenth of the month, even though they were not billed until the end of the month. The adjustments for unbilled accounts would tend to raise the overall value of the accounts, and would presumably smooth down the fluctuations in that value resulting from monthly billings.

For example, on June 27, the date on which outstanding billings dropped to their low point of $129,000, total outstanding uncollected accounts subject to Rose City's security interest were closer to $180,000, since 27/30 of the approximately $50,000 of circulation accounts which were billed at the end of June had been earned. A similar adjustment should be made as of September 28, the date on which the secured creditors appointed a trustee to collect the accounts. Since the Bankrupt ceased doing business two days later, all but a small portion of the approximately $71,000 of accounts billed after September 28 were earned and subject to Rose City's security interest on that date.

The second requirement, referred to above and suggested on pages 46 and 47 of the Trustee's Brief, raises questions as to how the real value of the accounts is to be determined. Is it market value, forced-sale value, or the amount ultimately collected thereon regardless of the circumstances of such collection? Since the Trustee has failed to introduce any evidence on the valuation question, it is unnecessary to answer these questions other than to assert that, where an account increases in value while it is in the collateral pool—which might be the case if an insolvent account debtor becomes solvent and is able to pay in full—it should be valued at its full value throughout the entire period that it is in the collateral pool. Compare *In re Hygrade Envelope Corp.*, 393 F. 2d 60 (2d Cir. 1968). This assertion is perfectly consistent with what one writer has referred to as the "fat pig" mortgage, where there is no preference under Section 60 despite the fact that the pig grows heavier and more valuable during the four-month period. See Hogan, "Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing," 53 Cornell L.R. 553, 558 (April, 1968).

The third requirement is suggested by the fact that Rose City claimed as its collateral not only accounts of the Bank-

rupt but also its contract rights. Under Section 9-106 of the Code (O.R.S. § 79.1060) both accounts and contract rights are rights to the payment of money. The essence of the distinction between them is that an account is a right to payment that has been earned and a contract right is a right to payment that has not yet been earned. Contract rights would include the Bankrupt's unearned rights to payment under all its circulation contracts and under whatever advertising contracts it may have had.

The effect of an assignment of contract rights on the preference problem was considered in the important case of *Rockmore* v. *Lehman,* 129 F. 2d 892 (2d Cir. 1942), cert. den. 317 U.S. 700 (1943), reversing 128 F. 2d 564 (2d Cir. 1942). In that case, which was decided after the adoption of the 1938 amendment to the Bankruptcy Act, the debtor had entered into contracts with Calvert Distillers Corporation under which it was to furnish and maintain advertising signs for Calvert. The contracts were cancellable by Calvert upon due notice. The debtor assigned the contracts to one Abrams as security for loans which enabled it to build the signs. Proceeds of the contracts were paid to Abrams over roughly a two-year period. Thereafter creditors of the debtor filed a petition for reorganization under Chapter 10 of the Bankruptcy Act, and a trustee was appointed. Calvert deposited with the Court checks representing amounts due for services rendered during the three months prior to the Chapter 10 proceeding. The Court, speaking through Judge Augustus Hand, held that, in determining the application of Section 60 of the Bankruptcy Act, the date of the assignment of the contracts rather than the date on which the accounts were earned governed the imposition of the lien on any accounts due from Calvert under the contracts.

On this issue it looked to state law and found that, under the law of New York, once the contract had been assigned,

the rights of the assignee to the present and future accounts thereunder were good against bona-fide purchasers within the meaning of the test then established in Section 60. The same result would have occurred in the case had New York then had the Uniform Commercial Code. Under Section 9-306 (O.R.S. § 79.3060) proceeds are defined to include "the account arising when the right to payment is earned under a contract right." The Section goes on to provide that a security interest in proceeds "is a continuously perfected security interest if the interest in the original collateral was perfected." Comment 2(b) to the Section indicates that the reference to the continuity of the security interest is to "make clear that the four month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original collateral and not with the date of his obtaining control of the proceeds" (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 670).

In the case before this Court it should be noted that Rose City's financing statement described the collateral as "accounts receivable." Since the Trustee introduced no evidence on the value question, the Court will not have to decide whether this description is broad enough to cover the assignment of the unearned rights to payment under Bankrupt's circulation and advertising contracts. If it is broad enough, accounts arising after June 15, 1964 (the beginning of the four-month period prior to bankruptcy), out of contracts which were outstanding on June 15, 1964, are to be treated as having been transferred before June 15, 1964. This requires that they be treated in the same manner as any other item of collateral which increases in value during the four-month period. As previously suggested, where collateral increases in value during the four-

month period, it should be treated throughout the period at its ultimate value.

In light of the difficulties of accurately applying the *strict test* in many situations involving a collateral pool, the refusal of the Court in *In re Pusey, Maynes, Breish Co., supra,* to decide whether the *strict test* is required seems wise. At least three other courts seem to have adopted different tests.

In *Wolf* v. *Aero Factors Corporation,* 221 F. 2d 291 (2d Cir. 1955), the Court, in upholding cross-collateral provisions in a financing arrangement entered into prior to the four-month period which involved a series of advances made against assignments of accounts during the four-month period, found no preference because each assignment was made "for a fair and present consideration." In some cases accounts assigned brought more than the advance made against them, and in others they brought less. The Court permitted the excess in the one case to be used to make up the deficiency in the other without any effort to apply strict substitution of collateral rules. It rejected the Trustee's argument that each of the transactions should be looked at separately.

In *Matthews* v. *James Talcott, Inc.,* 345 F. 2d 374 (7th Cir. 1965), cert. den. 382 U.S. 837 (1965), the secured party was financing both inventory and receivables under separate arrangements entered into prior to the four-month period. The inventory financing was secured pursuant to the Indiana Factors Lien Act, which required designations of the inventory. Citing cross-collateral provisions in the factor's lien agreement, the Court held that four designations of inventory made during the four-month period secured receivables loans made during the same period where the receivables turned out to be worthless. It so held even though one of the designations was made on the day fol-

lowing the last receivables loan. Here, also, the Court made no effort to apply strict substitution of collateral rules.

In re Hygrade Envelope Corp., 393 F. 2d 60 (2d Cir. 1968), involved a security interest in inventory and receivables of the Bankrupt arising under the New York Factors' Lien Act, a law under which the factor's interest in any account was inferior to the lien of an attaching creditor until the factor either notified the account debtor of his interest in the account or until he obtained an additional assignment of the account from the borrower. The Court sought to determine whether new inventory and new accounts of the borrower arising between November 26 and the following January 24, the date of bankruptcy, could secure indebtedness of the borrower outstanding on November 26 without being preferential. It gave as an example a sale by the borrower on December 10 of $10,000 worth of pre-November 26 inventory, and pointed out that, under *Pusey,* new inventory or receivables to which the factor's lien attached on or before December 10 could be substituted as collateral in place of the inventory sold. It pointed out, however, that under the strict substitution rules of the early cases the account receivable arising from the sale of the inventory often could not, under the New York statute, be substituted for the inventory, since the perfection by notice to the account debtor or by a new assignment might not occur until some period after the inventory had been sold, thus violating the first of the two substitution-of-collateral rules advocated by the Trustee.

The Court suggested that this rule was really based on the rule of *Benedict* v. *Ratner,* which under New York law did not apply to factors' liens. It therefore held that there would be no preference as to *any* post-November 26 receivable or inventory which merely replaced similar security

held on that date. This is not unlike Judge Solomon's decision below (R. 100). In effect, this approach compares values at the beginning and end of the period and ignores fluctuations in between. Compare *Pasadena Investment Co.* v. *Pasadena Air Products, Inc.*, 234 F. Supp. 128 (S.D. Cal. 1964).

The Courts were dealing in *Wolf* and *Matthews* with assignments of accounts and designations of inventory which were executed and delivered during the four-month period, and in *Hygrade* with assigned accounts where notice or an additional assignment was required during the period. All three cases, however, involved continuing financing arrangements which were entered into before the beginning of the four-month period, and all three involved collateral arising in the ordinary course of business. To this extent they may be regarded as forerunners of the rule in Section 9-108 of the Code (O.R.S. § 79.1080).

B. Section 60 is Aimed at the Creditor who Seeks to Strengthen his Position when Trouble Seems Imminent.

Prior to the 1938 amendments to the Bankruptcy Act courts had held that a number of types of security interests which were created four months prior to the bankruptcy were not preferential where the defects (including lack of public notice) were remedied by some action taken before bankruptcy, even though such action was taken within the four-month period. The most famous of these cases is *Sexton* v. *Kessler*, 225 U.S. 90 (1912), in which the debtor agreed with the secured party to hold specified securities as security for its indebtedness to the secured party, but did not deliver the securities to the secured party until four years later, just two weeks before the debtor's bankruptcy. The Supreme Court held that the secured party's

security interest in the securities was not preferential, since the transfer of the securities took place four years before the delivery; the theory being that the agreement to hold the securities for the secured party created an equitable lien.

The 1938 amendment to Section 60, which provided that the transfer did not take effect until the transferee's interest was good against a bona-fide purchaser, was aimed directly at reversing this result; the theory of this solution being that equitable liens were not good against bona-fide purchasers. Unfortunately, this vulnerability to the rights of bona-fide purchasers was also shared by certain legal security interests such as the security interest in inventory, which was always subject to defeat by a buyer in the ordinary course of business, and the security interest in accounts receivable, which in some states under certain circumstances was subject to defeat by subsequent assignees.

The 1950 amendments were designed to remedy this defect. Their basic purpose was "to retain unimpaired the basic object of the 1938 amendment, which eliminated the relation-back doctrine of *Sexton* v. *Kessler* . . ." H.R. Rep. No. 1293, 81st Cong., 1st Sess. 6 (1949). The amendments accomplished this by substituting the lien-creditor test for the bona-fide purchaser test, but, since certain equitable liens were, under state law, good against lien creditors, it was felt necessary to add paragraph (6) of Section 60a, which deals specifically with the problem of equitable liens.[7]

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[7] Professor Gilmore points out that no one can be sure what is meant by "equitable lien." 1 Gilmore, Security Interests in Personal Property, 198-200. Comment (2) to Section 9-204 makes it clear that a security interest under the Code in after-acquired property is a legal rather than an equitable interest, since no further action by the secured party is required (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 643-644).

It has been pointed out that Section 60 is aimed at the unsecured creditor or imperfectly secured creditor who tries to strengthen his position against other creditors when trouble seems imminent. See 1 Coogan, Hogan & Vagts, Secured Transactions Under the UCC 1393-1394 (1963). As indicated by *Rockmore* v. *Lehman, supra,* the creditor who establishes his position more than four months before bankruptcy is unaffected. In *Rockmore,* although the accounts came into being during the four-month period prior to bankruptcy, the secured party did not have to take any further action in order to perfect his interest in them. His legal position had been solidified prior to the four-month period. All that remained was for the debtor to earn the accounts.

More specifically, it has been suggested that the 1938 and 1950 amendments to Section 60 were aimed at three evils: the unrecorded mortgage, the equitable lien on presently-owned property, and those after-acquired property interests where some additional step such as recording or taking of possession was required. Compare *Eberly* v. *Dudley,* 314 F. 2d 8 (9th Cir. 1962). They were not aimed at publicly filed security interests in after-acquired property where no additional step was required to obtain and perfect the security interest. See Friedman, "The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under the Code," 108 U. Penn. L. Rev. 194, 204 (1959). See also the testimony of Professor McLaughlin in the Hearings on the 1938 Act, Hearings before the Committee of the Judiciary of the House Studying the Revision of the Bankruptcy Act, 75th Cong., 1st Sess., Ser. 9, 123 (1937); and 2 Glenn, Fraudulent Conveyances and Preferences § 576 (1940 ed.).[8]

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[8] Compare *Joe Heaston Tractor and Implement Co.* v. *Claussen,* 59 N.M. 486, 287 P. 2d 57 (1955); *In Matter of Hayes,* 140 F. Supp. 444 (D. Alaska, 1956); *In Matter of Platt,* 4 C.C.H. Installment

C. Section 9-108 (O.R.S. § 79.1080).

Consistent with these views, the Permanent Editorial Board is of the opinion that within the limits set by Section 9-108 of the Code (O.R.S. § 79.1080) a security interest in after-acquired property created more than four months prior to bankruptcy which ripens during the four-month period is no more preferential under Section 60 than a contract right which ripens into an account during the four-month period.

Section 9-108 (O.R.S. § 79.1080) provides as a principle of state law that—

> "Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

The Section makes it clear that, to the extent state law may be applicable, state law does not regard a security interest in after-acquired property as being given on account of an antecedent debt (1) if the secured party gives new value which is to be secured by such after-acquired

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Credit Guide 89033 (D.C. E.D. Pa. 1966), vacated on other grounds, 4 C.C.H. Installment Credit Guide 889-35 (Aug. 8, 1966); and *In re Goodfriend,* 4 C.C.H. Installment Credit Guide 89435 (E.D. Pa. 1964). All of these cases involved security interests in after-acquired property, some of which must have been acquired within four months of bankruptcy and in none of which was the preference issue raised.

property, and (2) if the debtor's interest in such after-acquired property arises in the ordinary course of his business. The Trustee argues on page 25 of his Brief that Rose City's security interest was not given for new value, since only a portion of the indebtedness secured by the security agreement was advanced on the date of the execution of the agreement. Even if this is so, there is little doubt that the releases of Rose City's perfected security interest in the accounts arising between November 22, 1963, and June 15, 1964, were new value within the specific language of Section 9-108. Nor has there been any dispute about the fact that the accounts outstanding on September 28, 1964, arose in the ordinary course of the Bankrupt's business.

Section 9-108 has been attacked as an effort to invade the province of the Bankruptcy Act itself. The Board asserts that it has no such purpose, and agrees that, if the policy of the Bankruptcy Act was contrary to Section 9-108, the policy of the Bankruptcy Act would control. The history of the Bankruptcy Act in the context of the personal-property security law in existence at the time the Bankruptcy Act was drafted strongly suggests that the policy of the Bankruptcy Act and Section 9-108 are in harmony.

In *Rockmore* v. *Lehman, supra,* the determination of whether the security interest in the accounts earned by the debtor during the four-month period was voidable turned entirely on the Court's interpretation of state law. In fact, the Court reversed itself when it changed its interpretation of the state law. To the extent that the intention of the Legislatures enacting the Code is important to the determination of the interaction between the Code and Section 60, that intention has been made clear in Section 9-108 (O.R.S. § 79.1080).

To the extent that there has been no clear interpretation of the application of Section 60 of the Bankruptcy Act to

a security interest in after-acquired property, we think that language used by Judge Friendly in connection with a problem under Article 2 of the Code is valid and applicable. In *United States* v. *Wegematic Corporation,* 360 F. 2d 674, 676 (2d Cir. 1966), he said:

> "We find persuasive the defendant's suggestion of looking to the Uniform Commercial Code as a source for the 'Federal' law of sales. The Code has been adopted by Congress for the District of Columbia, 77 Stat. 630 (1963), has been enacted in over forty states, and is thus well on its way to becoming a truly national law of commerce, which, as Judge L. Hand said of the Negotiable Instruments Law, is 'more complete and more certain, than any other which can conceivably be drawn from those sources of "general law" to which we were accustomed to resort in the days of Swift v. Tyson.' New York, N.H. & H. R. Co. v. Reconstruction Finance Corp., 180 F. 2d 241, 244 (2d Cir. 1950). When the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce, important but still small in relation to the total, consisting of transactions with the United States."

This view is echoed in *Rosenberg* v. *Rudnick,* 262 F. Supp. 635, 639 (D. Mass. 1967), where the Court said:

> "The Bankruptcy Act itself does not define antecedent debt. In view of the fact that the Uniform Commercial Code has now been adopted by 48 states, it would seem that the definition of §9-108 should be regarded as generally accepted and in accord with current business practice and understanding and hence applied in bankruptcy."

In *In re White*, 283 F. Supp. 208 (S.D. Ohio, 1967), another case dealing with an after-acquired property interest in a pool of collateral acquired under the Uniform Commercial Code, the Court concurred with the conclusion that Section 9-108 does not permit the evil which Section 60 seeks to prevent.

It has been suggested that the tests established by Section 9-108 come closer to the objectives of Section 60 than some of the rules expounded in early cases thereunder. See Hogan, "Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing," 53 Cornell L.R. 553, 565 (April, 1968).

The Board believes that Section 9-108 (O.R.S. § 79.1080) provides the correct principles to be applied in this case both because it avoids the difficulties of applying the *strict test* and because it is entirely consistent with the fundamental objectives of Section 60.

V. The Transfer of the Accounts Occurred Prior to the Beginning of the Four-Month Period.

The District Court held that the accounts claimed by Rose City which came into existence during the four-month period were, for the purpose of Section 60, transferred to Rose City prior to the four-month period. In so holding it followed *Rosenberg* v. *Rudnick, supra,* which involved a pool of inventory rather than a pool of accounts. In both cases the loan was made, the security agreement was signed and the financing statement was filed more than four months prior to bankruptcy. In both cases this holding was opposed on the basis of the first sentence of Section 60a(2), which reads as follows:

> "For the purposes of subdivisions a and b of this section, a transfer of property other than real property

> shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the right of the transferee''—

and on the basis of Sections 9-303 and 9-204(1) of the Code (O.R.S. §§ 79.3030 and 79.2040(1)), which provide that a security interest cannot be perfected until it has attached and a security interest cannot attach until the debtor has rights in the collateral. The Court below agreed with the Court in *Rosenberg* that the making of the loan, the execution of the security agreement and the filing of the financing statement were all the steps that were necessary to ''so far perfect'' the secured party's interest in the collateral arising during the four-month period that no subsequent lien creditor could obtain superior rights (R. 96-98). It is clear under both the Code and the provisions of Oregon law relating to attachment and execution[9] that no subsequent lien creditor could obtain superior rights.

Both Courts supported this conclusion by reference to the ''Mississippi River'' or entity concept articulated by Judge Magruder in *Manchester National Bank* v. *Roche,* 186 F. 2d 827, 831 (1st Cir. 1951), in which he said:

> ''By analogy it might be possible to treat a merchant's accounts receivable as a unit presently and continuously in existence, the component elements of which (the particular accounts) may be constantly changing, without affecting the identity of the *res;* so that a general assignment by way of security of

[9] See O.R.S. Sections 29.170 and 23.410 and compare *William Iselin & Co.* v. *Burgess & Leigh, Ltd.,* 276 N.Y. Supp. 2d 659, 52 Misc. 2d 821 (Sup. Ct. 1967).

> accounts receivable present and future might be deemed to create *in praesenti* a lien upon this enduring unit, the accounts receivable, which lien would persist as a floating charge upon such *res,* however much its component elements might change from time to time by the payment of old accounts and the creation of new ones."

It is submitted that these holdings are in full conformity with the objectives of Section 60.

VI. Conclusion.

The Referee's decision in this case is sharply inconsistent with Section 9-205 of the Code and, if reinstated, would seriously interfere with the development of simplified financing procedures envisaged by the Code. The decision of the District Court in Oregon, like similar decisions in Massachusetts and Ohio, is fully in accordance with the purposes and objectives of Section 60a. It meets the technical tests of Section 60a because the transfer of the collateral in dispute is deemed to have taken place prior to the four-month period. Even if the transfer is to be regarded as having taken place during the four-month period, however, the result is fully supported by pre-Code rules regarding substitution of collateral and by Section 9-108 (O.R.S. § 79.1080).

Respectfully submitted,

RUPERT R. BULLIVANT,
JAMES C. DEZENDORF,
JOSEPH McKEOWN.

Appendix

Figure 1

BILLINGS AND COLLECTIONS OF BANKRUPT, JUNE 15-SEPTEMBER 28, 1964.†

Period	Proceeds of assigned accounts collected and used by bankrupt			New billings			Outstanding advertising and circulation billings at end of period
	Advertising	Circulation	Total collections	Advertising billings	Circulation billings	Total billings	
							$144,255.70*
6/15-30	$47,478.68	$ 6,835.37	$54,314.05	$42,274.77	$57,341.58	$99,616.35	189,540.15
7/1-15	32,663.60	49,787.40	82,451.00	32,997.64	1,895.43	34,893.07	141,982.22
7/16-31	24,948.50	8,022.85	32,971.35	35,457.15	51,225.02	86,682.17	195,693.04
8/1-15	30,878.33	45,222.04	76,100.37	36,299.39	4,769.51	41,068.90	160,661.51
8/16-31	25,876.82	9,505.31	35,382.13	27,205.67	48,047.32	75,252.99	200,532.43
9/1-15	35,790.82	46,675.35	78,466.17	22,470.33	2,396.01	24,866.34	146,932.60
9/16-28	30,378.95	7,796.22	38,175.17	30,707.81	1,998.24	32,706.05	141,463.48
	$228,015.70	$173,844.54	$397,860.24‡	$227,412.76	$167,673.11	$395,085.87	

*Outstanding billings on June 15.

†Figures for each fifteen days are totals of the daily figures appearing in Exhibit 39.

‡This figure appeared in the Board's Brief in the District Court, was not disputed, and was found to be the amount collected (R. 100). The Trustee now argues that it may include credits and write-offs. Such credits and write-offs would be likely to reduce the total billings so that total collections from June 15 to September 28 would still be expected to exceed total billings (Trustee's Brief, 45).

DERIVATION OF THE STRICT TEST.

It is asserted on page 20 of this Brief that the following two substitution-of-collateral rules urged by the Appellant—

1. The new collateral must be transferred to the secured party either prior to or contemporaneously with the release of the old collateral (the "timing rule");

2. If the new collateral is of greater value than the collateral which is released, a voidable preference for the difference in value will result (the "value rule")—

can be combined for the purpose of this case into the following rule:

> Where a changing pool of collateral secures fixed indebtedness during the four-month period prior to bankruptcy, the collateral in which the secured party has a security interest on the date of bankruptcy is subject to attack on grounds of preference to the extent that its value on the date of bankruptcy exceeds the lowest value of the collateral pool during the four months prior to the bankruptcy of the debtor (the "*strict test*").

That the *strict test* does combine both the timing rule and the value rule can be demonstrated by considering the following three hypothetical cases involving a fixed loan which exceeds the value of the collateral. In each case at the beginning of the four-month period prior to bankruptcy the collateral consists of four slow but collectible accounts receivable each in the amount of $25,000.

(1) In the first case, one new account of $25,000 arises and is assigned to the secured party three months before bankruptcy. One month later the debtor collects in full

ne of the four original accounts and is permitted to use
ıe proceeds. On the date of bankruptcy the three old ac-
ounts and the new account total $100,000. (2) The only
ifference between the first case and the second case is
ıat the new account is in the amount of $30,000 instead
f $25,000, so that the value of the collateral at bankruptcy
ɔtals $105,000. (3) In the third case the debtor collects
ne of the four accounts three months before bankruptcy.
'ne day later a new $25,000 account arises and is assigned
ɔ the secured party so that on the date of bankruptcy
ıe three old accounts and the new account which are un-
ollected total $100,000.

In the first case the lowest value of the collateral during
ıe four-month period is $100,000, which equals the value
f the collateral on the date of bankruptcy. Here there
; no preference because the old collateral was released
fter the new collateral was assigned, satisfying the tim-
ıg rule and because the new collateral had the same value
s the old collateral, satisfying the value rule.

In the second case the lowest value of the collateral dur-
ıg the four-month period is $100,000, which is $5,000 less
ıan its value at bankruptcy, resulting in the preference
f $5,000. This results from the violation of the value
ule. In the third case the lowest value of the collateral
; $75,000, resulting in a preference of $25,000. Here it is
ıe timing rule that has been violated.

Under the *strict test,* once the outstanding balance of
ccounts drops to any figure, there is no way that it can
e brought back up to the $100,000 on a non-preferential
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ıteral. This is true under the *strict test* whether the drop
ɔ a low figure occurs in one step or by several steps.

Derivation of the Strict Test.

It is asserted on page 20 of this Brief that the following two substitution-of-collateral rules urged by the Appellant—

> 1. The new collateral must be transferred to the secured party either prior to or contemporaneously with the release of the old collateral (the "timing rule");
>
> 2. If the new collateral is of greater value than the collateral which is released, a voidable preference for the difference in value will result (the "value rule")—

can be combined for the purpose of this case into the following rule:

> Where a changing pool of collateral secures fixed indebtedness during the four-month period prior to bankruptcy, the collateral in which the secured party has a security interest on the date of bankruptcy is subject to attack on grounds of preference to the extent that its value on the date of bankruptcy exceeds the lowest value of the collateral pool during the four months prior to the bankruptcy of the debtor (the "*strict test*").

That the *strict test* does combine both the timing rule and the value rule can be demonstrated by considering the following three hypothetical cases involving a fixed loan which exceeds the value of the collateral. In each case at the beginning of the four-month period prior to bankruptcy the collateral consists of four slow but collectible accounts receivable each in the amount of $25,000.

(1) In the first case, one new account of $25,000 arises and is assigned to the secured party three months before bankruptcy. One month later the debtor collects in full

one of the four original accounts and is permitted to use the proceeds. On the date of bankruptcy the three old accounts and the new account total $100,000. (2) The only difference between the first case and the second case is that the new account is in the amount of $30,000 instead of $25,000, so that the value of the collateral at bankruptcy totals $105,000. (3) In the third case the debtor collects one of the four accounts three months before bankruptcy. One day later a new $25,000 account arises and is assigned to the secured party so that on the date of bankruptcy the three old accounts and the new account which are uncollected total $100,000.

In the first case the lowest value of the collateral during the four-month period is $100,000, which equals the value of the collateral on the date of bankruptcy. Here there is no preference because the old collateral was released after the new collateral was assigned, satisfying the timing rule and because the new collateral had the same value as the old collateral, satisfying the value rule.

In the second case the lowest value of the collateral during the four-month period is $100,000, which is $5,000 less than its value at bankruptcy, resulting in the preference of $5,000. This results from the violation of the value rule. In the third case the lowest value of the collateral is $75,000, resulting in a preference of $25,000. Here it is the timing rule that has been violated.

Under the *strict test,* once the outstanding balance of accounts drops to any figure, there is no way that it can be brought back up to the $100,000 on a non-preferential basis by the mere addition of collateral, since all subsequent additions of collateral will be non-preferential only if they are followed by equal or greater releases of collateral. This is true under the *strict test* whether the drop to a low figure occurs in one step or by several steps.

A corollary of the *strict test* is the principle that, in a situation where the collateral is constantly changing, there can be no preference so long as the indebtedness is fully secured throughout the four-month period. If the indebtedness is fully secured throughout the period, it follows that the lowest value of the collateral during the period must equal or exceed the indebtedness. The Trustee concedes that a transfer made to a creditor who is fully secured is not preferential. Trustee's Brief, 22, Footnote 7.

In a case where both the secured indebtedness and the value of the pool of collateral change during the four-month period this test could be rephrased to make preferential that portion of the value of the collateral on the date of bankruptcy which exceeds an amount determined by subtracting from the indebtedness on the date of bankruptcy the greatest amount (if any) by which at any time during the four month period, outstanding indebtedness exceeded the then value of the collateral. Both tests are based on the hypothesis that any particular account or any particular item of inventory is treated as having one value throughout the time it is in the collateral pool.

No. 22507

In the

United States Court of Appeals

For the Ninth Circuit

R. Anthony DuBay, *Appellant,*
vs.
Everette H. Williams, *Appellee.*

Everette H. Williams, *Appellant,*
vs.
Rose City Development Co., Inc., *Appellee.*

Robert J. Davis, *Appellant,*
vs.
Everette H. Williams, *Appellee.*

Brief of National Commercial Finance Conference, Inc., Amicus Curiae

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AUTHORITIES CITED

No. 22,507

In the

United States Court of Appeals

For the Ninth Circuit

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vs.
EVERETTE H. WILLIAMS,
Appellee.

EVERETTE H. WILLIAMS,
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ROSE CITY DEVELOPMENT CO., INC.,
Appellee.

ROBERT J. DAVIS,
Appellant,
vs.
EVERETTE H. WILLIAMS,
Appellee.

Brief of
National Commercial Finance Conference, Inc., Amicus Curiae, in Support of the Position of Appellee Rose City Development Company, Inc.

INTEREST OF AMICUS CURIAE

This brief is respectfully filed upon the written consent of all parties to the appeal, pursuant to Rule 18(9)(a) of the Rules of this Court. Such written consent is submitted herewith.

The Amicus Curiae is a non-profit membership corporation. It is the national trade association for the commercial finance and factoring industry, having well over one hundred members of varying size, operating on a national, regional, or local scale. They offer secured credit to manufacturers, wholesalers, and retailers whose products and services embrace the entire economic range. While these borrowers are both large and small, the bulk of them are properly characterized as "small business".

The importance to small business of such financing and factoring facilities has long been recognized. Ten years ago, the Board of Governors of the Federal Reserve System reported to the Congress as follows ("Financing Small Business", Report to the Committees on Banking and Currency and the Select Committees on Small Business, April 11, 1958, Volume 2, Survey IV, pp. 1-3):

> "Commercial finance companies and factors play a significant role in the financing of small businesses in manufacturing and wholesale trade. Commercial financing and factoring are particularly significant in a study of small business financing because credit is made available to small businesses that do not have access to bank credit or to the markets for equity and long-term debt funds."

Statistics compiled by the Amicus Curiae from published financial reports, and from figures supplied by its own members, indicate that the Amicus Curiae's industry transacts an annual volume of secured financing in excess of $26 bil-

lion. A substantial additional amount is transacted by commercial banks and others. The largest single segment of such business consists of the financing or factoring of accounts receivable, which is the classic form of secured financing.

STATEMENT OF THE CASE

The relevant facts and the applicable law are fully presented in the briefs of the parties, and need not be repeated. The only matter with which the Amicus Curiae is here concerned is the practical importance of the case because of its impact upon accounts receivable financing and factoring and the cost thereof.

The Amicus Curiae respectfully submits that the decision below, insofar as it upheld the claim of appellee Rose City Development Company, Inc. to the bankrupt's accounts receivable, should be affirmed.

ARGUMENT

The usefulness to a small businessman of financing upon his accounts receivable obviously depends in large measure on the cost.

Prior to the Uniform Commercial Code, such financing could not be done on a legally sound basis unless the financing institution insisted on strict dominion over the accounts receivable and their proceeds. This meant that each individual account receivable had to be assigned in writing; that the checks received on the assigned accounts had to be delivered to or deposited to the credit of the financing institution; and that the latter had to control and police the transactions by maintaining, in effect, a duplicate accounts receivable ledger in which it recorded all shipments, assignments, merchandise returns, payments, and other credits. All these things had to be done on a continuous

daily basis, because the pre-Code law required them to be done as a legal prerequisite to the perfection of the assignee's rights. This was the "dominion" rule as originally announced in *Benedict v. Ratner*, 268 U.S. 353 (1925). Necessarily, the bookkeeping and other overhead expense of such detailed procedures was reflected in the cost of financing.

Under the Code, there is no need for specific assignments of the individual accounts, because the security agreement itself may constitute the assignment [Section 9-204(3)]; and there is no need for the strict handling of account-debtors' checks or for daily advances and repayments, because the dominion rule is abolished by the Code [Section 9-205]. As a result, the overhead cost of the operation can in many cases be substantially lower than heretofore.

Since the Code has been enacted in 49 of the 50 States, as well as by the Congress itself (for the District of Columbia), it is obvious that the streamlined and less expensive procedures provided by the Code for accounts receivable financing are consonant with our State and Federal public policy. The Amicus Curiae is aware that many of its members, as well as other institutions engaged in secured financing, employ the Code techniques in their handling of loans secured by accounts receivable and inventory collateral, to the benefit of themselves and their borrowers.

In the instant case, the Referee conceded that the claim of Rose City to the accounts receivable on hand at the date of bankruptcy would probably have been unassailable if Rose City had utilized the daily advances and repayments procedure which was generally employed prior to the advent of the Uniform Commercial Code [Transcript of Record, Volume One, pp. 36-37]; but he also acknowledged that such procedures were cumbersome [Transcript of Record,

Volume One, p. 37, line 13]. In the District Court, Judge Solomon made the same point, noting that the "old method was both expensive and cumbersome and necessarily increased the cost of money" [271 Fed. Supp. 395, at p. 400].

Affirmance by this Court with respect to Rose City's claim would protect the flexibility and minimize the cost of accounts receivable financing, just as is contemplated by the Code. Reversal by this Court, on the other hand, would force secured parties to revert to the archaic pre-Code procedures, and the cost of such financing would inevitably be increased. Such a result would be regarded by the Amicus Curiae as adverse to the national interest, in that it would constitute an unjustified impediment to the vital flow of secured credit into the small businessmen who depend upon it for their day-to-day cash requirements.

CONCLUSION

The secured transactions between the bankrupt and Rose City were duly perfected in the manner prescribed by the Uniform Commercial Code, and the present attack upon Rose City's claim to the assigned accounts receivable should fail. In the factual context of this case, there is no legal or moral conflict between the provisions of the Code and the provisions of the Bankruptcy Act, because Rose City's collateral position was not improperly improved, at the expense of any other creditor, during the four-month period preceding bankruptcy.

Most importantly, a decision adverse to Rose City would have a serious adverse effect upon the integrity and availability of modern accounts receivable financing and factoring, because it would increase the risk and cost of administering the transactions and resultantly the cost thereof to the small businessmen who require such financial services.

The decision below should be affirmed as to appellee Rose City Development Company, Inc.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES B. WERSON
Attorney.

No. 22507-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EVERETTE H. WILLIAMS,

Appellant,

vs.

ROSE CITY DEVELOPMENT COMPANY, INC.,

Appellee.

On Appeal From the United States District Court for the District of Oregon.

BRIEF OF APPELLANT.

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No. 22507-A

IN THE

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FOR THE NINTH CIRCUIT

Everette H. Williams,

Appellant,

vs.

Rose City Development Company, Inc.,

Appellee.

On Appeal From the United States District Court for the District of Oregon.

BRIEF OF APPELLANT.

Jurisdiction.

This is a controversy arising in a proceeding in bankruptcy, involving conflicting claims to the proceeds of the bankrupt's accounts receivable. This Court has jurisdiction of the appeal from the final order below under Section 24a of the Bankruptcy Act, 11 U.S.C. §47a.

Statement of the Case.

This is an appeal by the trustee in bankruptcy of Portland Newspaper Publishing Co., Inc. from the final order of the District Court made November 7, 1967, insofar as that order upheld a secured claim of

appellee Rose City Development Company, Inc. [C. Tr. 115].*

Portland Newspaper Publishing Co., Inc. was adjudicated bankrupt upon an involuntary petition filed by wage claimants on October 15, 1964 [C. Tr. 6]. Following a general reference of the proceeding to Referee in Bankruptcy Estes Snedecor, appellant was appointed trustee.

The present controversy involves rights in the proceeds of the bankrupt's accounts receivable. Claims based upon alleged security interests in the accounts were filed by R. Anthony DuBay [Ex. 16], Robert J. Davis [Ex. 15], and appellee Rose City Development Company, Inc. [Ex. 17]. Appellee conceded that its position was junior to that of DuBay and Davis.

Appellant objected to all of the secured claims and sought to preserve the liens or security interests for the benefit of the bankrupt estate. He asserted various theories; the one applicable to appellee's case was that the security interests were voidable preferences to the extent they attached to accounts arising within four months of bankruptcy.

Following a trial, Referee Snedecor, by order dated February 9, 1966, sustained the objections. The DuBay and Davis claims were entirely invalidated, and appellee's was voided on the preference ground [C. Tr. 59].

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*The citation "C. Tr." in this Brief refers to the Clerk's Transcript which is Volume I of the Transcript of Record. The reporter's stenographic record of the proceedings before the Referee in Bankruptcy comprises Volumes II through V of the Transcript of Record and is referred to as "R. Tr." The various exhibits are referred to by the designation "Ex." and the identification number assigned to them by the Referee.

Appellee filed its Petition for Review on March 11, 1966 [C. Tr. 72]. DuBay and Davis also sought review. On August 22, 1967, Chief Judge Gus J. Solomon rendered his opinion, affirming the Referee as to DuBay and Davis, but reversing as to appellee and allowing its secured claim [C. Tr. 89]. The final order was entered November 7, 1967 [C. Tr. 115].

On December 5, 1967, appellant filed his Notice of Appeal to this Court with respect to that portion of the order below which sustained the secured claim of appellee Rose City Development Company, Inc. [C. Tr. 117].

Statement of Facts.

In November 1959, Portland's two daily newspapers were struck by various local unions. On February 4, 1960, certain labor unions affected by the strike formed Portland Reporter Publishing Co., Inc. (hereinafter "Reporter"), the predecessor of the bankrupt, for the purpose of continuing publication of a paper. Eighty-eight local unions concurrently sponsored the incorporation of appellee Rose City Development Company, Inc. (hereinafter "Rose City"), which was to acquire business premises and lease them to the Reporter [C. Tr. 2].[1]

From 1960 to the time of bankruptcy in October 1964, the Reporter, and the bankrupt as its successor, continuously operated at a loss, relying upon loans, favorable rental agreements, contributions, and the sale of stock for operating capital [C. Tr. 2-4]. Among other well-wishers, Rose City loaned money to the Re-

[1]The Referee's opinion contains comprehensive findings of fact [C. Tr. 1-59]. These findings are substantially undisputed except as to the matters concerning the bankrupt's insolvency and appellee's knowledge thereof.

porter at various times on an emergency basis to meet payrolls, taxes, and other expenses [C. Tr. 52; R. Tr. 28, 211, 236]. As evidence of the sums of moneys so loaned, the Reporter executed promissory notes in favor of Rose City in the amounts of $45,000.00 and $10,300.00 on November 16, 1963 and November 22, 1963, respectively [Ex. 17].

To secure the two notes, Rose City and the Reporter entered into a security agreement dated November 22, 1963. The agreement, among other things, granted to Rose City a security interest in "all accounts receivable of the debtor now existing or hereafter arising . . . except those heretofore assigned as disclosed by financing statements filed prior to the date hereof until such accounts so assigned are released," "all contract rights of the debtor now existing or hereafter arising relating to sales of goods or performance of services or both in the course of the debtor's business," and "proceeds and products of all of the above." [Ex. 17].

R. Anthony DuBay and Robert J. Davis also were providing financial assistance to the newspaper. They, too, sought security in the Reporter's accounts receivable, and there was excepted from the collateral made subject to the Rose City security interest those accounts assigned to DuBay and Davis [C. Tr. 35; Exs. 15, 16, 17].

The Rose City security agreement permitted the Reporter to collect and use the receivables and the proceeds as its own, without imposition of any policing or accounting requirements [Ex. 17]. Except for one brief period when a default had been declared [Ex. 39; *Cf.* R. Tr. 146-147], Rose City in fact exercised no supervision of the collateral [C. Tr. 35].

Under the provisions of the Uniform Commercial Code, which had become effective in Oregon,[2] a financing statement executed by the Reporter and Rose City was filed on November 26, 1963. It identified the collateral as "accounts receivable," but did not disclose a claimed security interest in either contract rights or proceeds of the collateral [Ex. 3].

At the end of April 1964, as part of a proposal for further financing by Robert J. Davis, the Reporter was merged into the bankrupt, a new corporation named Portland Newspaper Publishing Co., Inc. [Ex. 19; C. Tr. 4]. While the bankrupt under the merger plan took over the Reporter's assets and agreed to assume the predecessor's liabilities [Ex. 19; R. Tr. 360], it did not enter into a new security agreement with Rose City. Nor did the parties ever execute or file a financing statement relating to the bankrupt's accounts. Rose City continued the practice of permitting the bankrupt to collect and use the receivables arising after the merger free of restriction or accountability [C. Tr. 35].

On September 27, 1964, the board of directors of the bankrupt found that further publication of the paper held no reasonable expectation of profit and resolved to discontinue business on September 30, 1964 [C. Tr. 5]. By a letter dated September 28, 1964, Rose City directed the bankrupt to transmit the cash proceeds collected from its receivables to a named representative

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[2]The Uniform Commercial Code became effective in Oregon on September 1, 1963. Citations to the Code in this Brief are to the section numbers as designated in the official text. These can be converted to the Oregon Revised Statutes citation by changing the dash to a decimal point and expanding the number by adding the digit "7" at the beginning and the digit "0" at the end. Thus, §9-108 of the official text is O.R.S. §79.1080.

of Rose City, DuBay and Davis, all of whom claimed interests in those accounts [Ex. 39; C. Tr. 91].

On October 15, 1964, certain employees of the bankrupt filed an involuntary petition in bankruptcy, and adjudication followed four days later [C. Tr. 6].

From and after September 29, 1964, the creditors' representative collected the accounts receivable of the bankrupt and deposited the proceeds in a special trust account. After bankruptcy, a similar course of collecting was followed under an agreement that the trust account would be held pending determination of the respective rights by the bankruptcy court [Ex. 39].

There is now approximately $107,000 thus held under the agreement [Ex. 27; C. Tr. 6, 90]. The claimants asserting security interests in the fund include Rose City with a claim having a balance due of $53,122.36 plus interest, and DuBay and Davis who each have a claim for $25,000 plus interest [Exs. 15, 16, 17]. Approximately 5% of the fund in question represents collections of accounts in existence on June 15, 1964, the beginning of the four months' period preceding bankruptcy. The remaining 95% is the proceeds of receivables generated during the four months' period [C. Tr. 44]. At all material times, as both courts below found, the bankrupt was insolvent [C. Tr. 12, 94], and Rose City knew or had reasonable cause to know about this financial condition [C. Tr. 19, 95].

After a trial, the Referee in Bankruptcy held the security interests asserted by DuBay and Davis invalid

on various grounds. With respect to Rose City, he ruled the claimed interest preferential under §60 of the Bankruptcy Act, to the extent it attached to the 95% of the accounts coming into existence within four months of the petition as security for antecedent loans made in 1963 [C. Tr. 58-59].

On review, Judge Solomon affirmed as to DuBay and Davis. He held, however, that Rose City had a valid security interest in all respects and reversed the Referee on this aspect of the case [C. Tr. 104, 115].

Statutes Involved.

The various statutes involved are set forth in the Appendix to this Brief.

Specification of Errors.

Appellant contends that (1), Rose City's security interest is invalid under the Uniform Commercial Code itself, for failure of the parties to file a financing statement or to enter into a new security agreement with respect to the bankrupt's accounts receivable; and that (2), under §60 of the Bankruptcy Act, the security interest is preferential in any event to the extent it attached to accounts arising within four months of bankruptcy. It is submitted here that the decision below is erroneous in that it upheld Rose City's security interest and is thus inconsistent with both of the foregoing contentions.

Questions Presented.

1. Whether Rose City's security interest is invalid under the Uniform Commerical Code itself, in view of the failure to file a financing statement or to make a new security agreement relating to secured transactions with the bankrupt, as distinguished from the bankrupt's predecessor corporation.

2. Whether security interests, which attach to accounts receivable as they come into existence within the four months' period preceding bankruptcy, are preferential under §60 of the Bankruptcy Act, when the loans to be secured were made before the beginning of that period.

   Subsidiary questions are:

   a. Whether §9-108 of the Uniform Commercial Code applies in this case; if applicable, does it save otherwise preferential security interests from invalidation under §60 of the Bankruptcy Act.

   b. Whether, despite the attaching of security interests to accounts only as they arise within the four months' period, the transfer can be said to occur more than four months before bankruptcy on a *res* or entity theory of accounts as collateral, or under the perfection test of §60a(2) of the Bankruptcy Act.

   c. Whether, despite the attaching of security interests to accounts within the four months' period, the transfer can be said to be for contemporaneous rather than antecedent consideration on a substitution of collateral theory.

Summary of Argument.

Rose City's security interest in the accounts in question was unperfected under the terms of the Uniform Commercial Code. No financing statement was ever filed with respect to the receivables of the bankrupt, as distinguished from those of the predecessor corporation. Similarly, there was no written security agreement between Rose City and the bankrupt. These deficiencies made Rose City's security interest in the bankrupt's accounts vulnerable to the rights of a levying creditor, and made the security transaction unenforceable even as between the immediate parties. As a result, the trustee in bankruptcy can avoid the security interest not only as a preference, but also under the Code itself and §§70c and 70a of the Bankruptcy Act.

Even assuming full perfection of Rose City's security interest in present and future accounts under the Code, that interest was invalid as a preference under the Bankruptcy Act to the extent it attached to accounts arising within four months of bankruptcy. The loans by Rose City to be secured by after-acquired accounts were made no later than November 1963. Under the express terms of the Code, the security interest cannot attach or arise, and perfection cannot occur, until the debtor has rights in the collateral; he has no such rights in accounts until they come into existence. Thus, as to any accounts generated between June 15 and October 15, 1964, the security interest was transferred to Rose City within the crucial four months' period and with respect to antecedent indebtedness. The other elements of a recoverable preference being present, the trustee can invalidate Rose City's security under §60 of the Bankruptcy Act.

Section 9-108 of the Code cannot save Rose City's security interest for two reasons. The section in essence provides that if a present loan is made to a debtor or new value is otherwise given to him to be secured by after-acquired property, the security interest is deemed to be taken for new value and not for antecedent debt if the debtor acquires the future collateral in the ordinary course of business.

First, the section by its own terms does not apply to Rose City's case. It requires that new value be given at the time of the security agreement, whereas Rose City's advances had been previously made for various operating purposes over a period of time and thus were antecedent, at least in great measure, when the security agreement was made in November 1963.

Secondly, and more fundamentally, §9-108 conflicts with the Bankruptcy Act and is therefore invalid if it is applied so as to make contemporaneous a consideration which otherwise would be antecedent under §60 of the Act. Congress has not left the meaning of antecedent debt to state law. The clear meaning of antecedent debt as used in §60 is that the indebtedness of the bankrupt was incurred prior to the time of the questioned transfer, and this definition involves the federal policy of achieving a fair and equitable distribution of the bankrupt estate. The Chandler Act of 1938 amended the preference section for the purpose of abolishing the relation back doctrine theretofore followed by many states. Under that doctrine, certain defective transfers

were related back or said to have occurred when the parties made their original agreement rather than when the transfer was actually completed or perfected. By fictionally relating the original new value forward to the time the security interest attaches to after-acquired property, §9-108 achieves the same result as the forbidden relating back of the transfer to the time of the giving of new value. Thus, the federal and state laws clearly collide.

Efforts to reconcile §9-108 and §60 on a substitution of collateral doctrine or on some other theory which is consistent with the Bankruptcy Act are unavailing. To the extent such a theory might insulate the Code security interest from attack as a preference, it would do so with or without the existence of §9-108, and the section thus adds nothing to the secured party's case.

Two theories, sometimes referred to as the *res* theory and the lien creditor theory, have been asserted in an attempt to establish that the transfer in question occurred at the point the security agreement was made and the financing statement was filed, rather than at the time the accounts arose. The *res* theory views receivables collateral as a single entity, separate from the individual accounts which compromise it; the transfer of the entire *res,* both present and future components, is said to take place when the agreement is made and the consideration is given. This theory, however, cannot be squared with the Code itself. It disregards the express provisions that a security in-

terest cannot attach to accounts, and perfection cannot occur, until the accounts arise. Moreover, the Code draftsmen would not have needed a §9-108 to relate the new value forward to the time the collateral comes into existence if they had contemplated that the transfer of the entire *res,* including future collateral, took place when the new value was given in the first instance.

Another version of the *res* theory considers future accounts as proceeds of present contract rights or general intangibles. Since the latter can be presently transferred before they mature into accounts, the argument is that the transfer occurs when the collateral in its earlier form is made subject to the security interest. This version of the theory, however, has no application to the present case. For there is no showing in the record that the accounts claimed by Rose City arose under pre-existing contracts, and more importantly, the financing statement did not cover contract rights or general intangibles but only accounts receivable.

In any event the *res* theory could not be reconciled with §60. A theory which asserts that a present transfer of a security interest takes place before the debtor realistically has rights in the collateral suffers from the same vice as the discredited relation back doctrine. Functionally, this kind of transfer is too similar to a mere promise to give security in the future. Independently of the Code, §60 requires that the debtor have rights in the collateral before he can transfer it.

The lien creditor theory is based on §60a(2) of the Act, which provides that a transfer is deemed to be made when it became so far perfected under state law that no subsequent lien by judicial proceedings could become superior to the rights of the transferee. Since, under the Code, a levying creditor could not defeat the secured party's rights in the collateral at any time after the perfection step occurred—*i.e.* the financing statement was filed—the argument is that the transfer of the security interest to Rose City took place in November 1963. One fallacy in the lien creditor theory is that §60a(2) looks to state law—here §9-303(1) of the Code—for the date of perfection as against levying creditors. Regardless of the filing of the financing statement, under the Code such perfection does not occur before the accounts come into existence, even though there might be no instant in time when a judicial lien creditor could defeat the secured party. Moreover, as was also observed in connection with the *res* theory, §60 itself contemplates that a transfer cannot occur until the debtor has rights in the collateral. The function of §60a(2) is to postpone to a later date the time of a defective transfer which actually has taken place. It is not intended to relate backwards in time an actual transfer of the debtor's property merely because the perfection step occurred first.

Nor can Rose City's security interest be sustained on a substitution of collateral rationale. While substitution of collateral of equal value in exchange for a re-

lease of old collateral is non-preferential under §60, this doctrine requires that the replacement of new collateral must precede or be contemporaneous with the release of the old. If the release occurs first, the secured party becomes temporarily unsecured, and even a short delay in replacing the security results in a potential preference under §60. Thus, to bring himself within the substitution doctrine, the secured party must be able to match up replacements and releases to show that they took place at the requisite points in time. Some policing or keeping track of the debtor's use of the collateral seems essential for this purpose. Section 9-205 of the Code, which abolishes the dominion and control rule of *Benedict v. Ratner,* may enable the debtor to use the collateral freely without fraud being imputed as a matter of state law. But it does not, indeed could not, change the conditions which must be shown to exist before the substitution of collateral doctrine will apply under §60.

The present record does not support an application of the substitution doctrine. The only significant evidence bearing on the point is a stipulation entered into after decision by the Referee. This raw data, without more, is insufficient to support a conclusion that a true substitution of collateral occurred insofar as Rose City is concerned.

As a matter of overall §60 policy, Rose City's security interest should be invalidated. This was not the usual commercial financing situation where advances were made on the strength of receivables with the

lender at all times looking to the collateral for liquidation of the loans. The debtor was free to dispose of the collateral as it saw fit. Repayment of the loans was of secondary importance; the primary purpose was to maintain publication of the newspaper. Only when bankruptcy seemed imminent did Rose City look to its security. The policy of §60 forbidding a strengthening of position just before bankruptcy, does not permit a lender to behave like an unsecured creditor until the time of trouble, and then to take a secured stance. It also follows that invalidation of Rose City's security will not adversely affect legitimate financing transactions. Section 60 aside, prudent financiers do police their collateral for a number of business reasons, and this course of conduct, in proper cases, will enable them to meet the preference problem by showing true substitutions of collateral.

Finally, if Rose City's security interest is upheld, the case must be remanded for the purpose of determining, among other things, whether the senior DuBay and Davis interests should be preserved for the benefit of the bankrupt estate, and whether the parties meant Rose City to have any interest in the accounts intended for DuBay and Davis.

ARGUMENT.

I.

INTRODUCTION.

This case has been considered by many commentators to involve the intersection of the Uniform Commercial Code's provisions relating to after-acquired property with the avoiding power of a trustee under §60 of the Bankruptcy Act. These writers assume that Rose City was a creditor with a security interest fully perfected under applicable state law, and proceed to discuss whether the Code, which is deemed to embody and protect contemporary good business practice, can be reconciled with the federal statute. So viewed, one important aspect of the matter is the validity of §9-108 in bankruptcy proceedings.

The major portion of this brief is devoted to the broad issues which have received the attention of the law reviews,[3] but we submit that they are not clearly

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[3]See, *e.g.*, Gordon, Nahum, *The Security Interest In Inventory Under Article 9 of the Uniform Commercial Code and the Preference Problem,* 62 Colum. L. Rev. 49 (1962) *reprinted at* Coogan, Hogan, Vagts, Secured Transactions Under The U.C.C. (1967) (hereafter "Coogan Et Al.") ch. 11; Kennedy, Frank, *The Trustee In Bankruptcy Under The Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9,* 14 Rutgers L. Rev. 518, 539-549 (1960) reprinted at 1 Coogan Et Al., ch. 10, §§10.03[7]-[9] (1967); Riemer, Bernard, *Bankruptcy-Preference Conflict Between §9-108 of the Uniform Commercial Code and §60(a) of the Bankruptcy Act,* 70 Comml. L.J. 63 (1965); Viles, Robert, *The Uniform Commercial Code v. The Bankruptcy Act,* 55 Ky. L. Rev., 636 (1967); Coogan and Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture,* 69 Yale L.J. 203 (1959) *reprinted and revised* Coogan Et Al., ch. 13; Friedman, Harold, *The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under The Code,* 108 U. Pa. L. Rev. 194 (1959); Henson, Ray, *"Proceeds" Under The Uniform Commercial Code,* 65 Colum. L. Rev. 232 (1965); 3

presented for decision in Rose City's case. Thus, the Bankruptcy Act aside, there is a serious question here as to whether Rose City's security interest was ever perfected under the Code itself, and, indeed, whether there even existed an enforceable security agreement under state law. Again, there is doubt as to whether §9-108 of the Code is, on its own terms, applicable to the case at hand. In any event, the relationship between Rose City and its borrower was not typical of commercial financing transactions nor could it be considered "good business practice."

II.

ANY SECURITY INTEREST OF ROSE CITY IN THE ACCOUNTS OF THE BANKRUPT WAS UNPERFECTED AGAINST THE TRUSTEE IN BANKRUPTCY UNDER THE CODE ITSELF.

While a security interest may be valid as between the immediate parties as soon as it arises, the Uniform Commercial Code requires a perfection step as a condition of validity as to third persons, including levying creditors and trustees in bankruptcy. §9-301. Perfection of a security interest in the accounts of a debtor is accomplished by the filing of a financing statement. §9-302. The financing statement may be a simple document, but there are some minimum requirements. Among the things it must contain are the signature of the debtor and a description of the collateral. §9-402.

Although a financing statement was filed covering transactions between Rose City and the bankrupt's

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Collier on Bankruptcy ¶60.51A (6th Ed. 1964); Gilmore, Security Interests in Personal Property chs. 8, 45 (1965); see also authorities collected at Viles, *supra,* nn 1-16.

predecessor, Portland Reporter Publishing Co., Inc., [Ex. 3], none was signed by nor filed with respect to the bankrupt, Portland Newspaper Publishing Co., Inc. True, the bankrupt acquired its predecessor's assets and liabilities in a merger [Ex. 19; R. Tr. 360], but both before and after the merger it was a distinct legal entity. At all times, the bankrupt bore a differferent name, was controlled by different shareholders, and had different corporate officers.[4] In short, during the course of its financing the publication of the newspaper, Rose City dealt with two separate and distinct "debtors." §9-105(d).

Yet only one financing statement was ever filed. Possibly, the financing statement filed with respect to Portland Reporter Publishing Co., Inc. served to protect Rose City's security interest in the accounts of that predecessor corporation which were transferred to the bankrupt in the merger.[5] But substantially all the accounts and proceeds in question arose after the

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[4]Under the terms of the merger, each share of the outstanding stock in the Reporter was exchanged for Class A, nonvoting shares in the bankrupt. On the other hand, Robert J. Davis and certain others received Class C, voting stock of the bankrupt [Ex. 19; R. Tr. 360]. Thus, as a result of the merger, control of the newspaper passed from the previous stockholders of the Reporter to the bankrupt's Davis group. Robert E. Webb, President of the Reporter and a member of its Board of Directors, became the assistant publisher of the bankrupt corporation, but was not a member of its board. Robert J. Davis was President and publisher of the bankrupt, but had not been an officer of the Reporter [R. Tr. 183-184].

[5]*Cf.* §9-306(2). *But see* Advanced Ali-Aba Course of Study on Banking and Secured Transactions Under the Uniform Commercial Code, *Course of Study Transcript 2* at 186-230 (1968), in which it is suggested that if a secured creditor consents to a transfer of his collateral to a new entity, he is under a duty to re-file as to the new debtor. It he fails to do so, he loses his security in the collateral so transferred.

merger [C. Tr. 44; Ex. 27]. These are the bankrupt's accounts; they never belonged to the predecessor corporation. The debtor whose collateral is now sought by Rose City was not named on the public record. See §9-105(d). The inescapable result is that the security interest in the bankrupt's accounts was at all times unperfected under the Code.

The failure to obtain and file a new financing statement in Rose City's case is not a mere technical or harmless oversight which may be excused or overlooked. The purpose of the filing requirement is to give notice to the world, or at least to any interested party who cares to examine the public records, of the existence or possible existence of security transactions. §9-402, Comment 2. A search of the record for security interests in the bankrupt's accounts would not have indicated any claim in favor of Rose City. To excuse the failure to file the financing statement, therefore, would be to frustrate an underlying policy of the Code itself.

Since Rose City's claim to the accounts of the bankrupt was unperfected under the Code, and was thus subject to the rights of levying creditors, §9-301(1)(b), (3), the security interest in any accounts remaining uncollected at bankruptcy was clearly preferential under §60 of the Bankruptcy Act. As will be more fully discussed in part III of this Brief, a transfer unperfected at the date of bankruptcy is, for the purpose of the preference section, deemed to have been made immediately before the filing of the petition.

Moreover, regardless of §60, the trustee's strong-arm or ideal lien creditor's rights under §70c of the Act

enable him to invalidate any security interest which remains unperfected on the date of bankruptcy. See also UCC 9-301(1)(b), (3).

The failure to file a financing statement has a similar result with respect to the proceeds of accounts actually collected on behalf of Rose City between September 29, 1964 and the date of the petition. As to these sums, the security interest may have become perfected by possession, but such perfection shortly before bankruptcy fixes the effective date of the transfer at this point, and brings it well within the four months' period for the purpose of §60. See part III of this Brief *infra.*

Up to now we have assumed that the security interest was binding under the Code as between the immediate parties. However, it can be argued forcefully that Rose City's claim lacked enforceability even as to the bankrupt. For a non-possessory security interest to be enforceable against the debtor, §9-203(1) requires that he sign a written security agreement which contains a description of the collateral. While the bankrupt generally assumed its predecessor's liabilities in the merger, it did not enter into new written security agreements with the various lenders. We submit that the contract betwen Rose City and the bankrupt's predecessor cannot serve the requirement of §9-203(1). It was not signed by the bankrupt, nor did it purport to convey a security interest in the bankrupt's accounts as distinguished from the predecessor corporation's accounts. The security interest in the accounts in question is thus unenforceable against the trustee by virtue of his standing in the position of the bankrupt under §§70a and 70c of the Bankruptcy Act.

III.

ASSUMING PERFECTION UNDER THE CODE, ROSE CITY'S SECURITY INTEREST IN ANY ACCOUNTS ARISING WITHIN FOUR MONTHS OF BANKRUPTCY IS INVALID AS A PERFERENCE.

A. All the Elements of a Voidable Preference Are Present.

We may assume for this argument that Rose City's security interest was properly perfected and fully enforceable under applicable state law, the Uniform Commercial Code as in effect in Oregon. Nevertheless it remains to be tested by the provisions of §60 of the Bankruptcy Act. This portion of Appellant's Brief will demonstrate that the security interest is a voidable preference to the extent it reaches accounts which came into existence within four months of bankruptcy.

A preference, as defined in §60a, consists of six elements: (1) a transfer of the debtor's property (2) to or for the benefit of a creditor (3) made while insolvent (4) within four months before bankruptcy (5) for an antecedent indebtedness (6) the effect of which is to enable that creditor to obtain a greater percentage of his claim than other creditors of the same class. The trustee can recover or avoid such preference under §60b if a seventh element is present, that is, if the creditor at the time of the transfer had reasonable cause to believe that the bankrupt was then insolvent.

Clearly the bankrupt's granting a security interest in its accounts was a "transfer" of its property within the meaning of the first element of a preference, §1(30), and Rose City was a creditor for the purpose of the second, §1(11). The factual elements of insolvency and reasonable cause to believe were found by both courts

below [C. Tr. 12, 18, 94-95]. The only serious questions relate to the time of the transfer and whether it was for antecedent indebtedness, that is, the fourth and fifth elements.[6] These will determine the existence of the sixth element as well.[7]

In connection with determining the time of a transfer, §60a(2) of the Act should be mentioned. If, under applicable state law, a transfer is not perfected when it is made as against a judicial lien or levying creditor, the date of the transfer is deemed to be the time it becomes so perfected. *Cf.* §60a(7). Or, if perfection has not occurred at all by the date of bankruptcy, the transfer is deemed to take place immediately before the filing of the petition.

Turning to the Code, it is abundantly clear that Article 9 does not contemplate the passage of any security interest in a given account, let alone a perfected one, until such time as the account actually arises or comes into existence. Section 9-204(3) does contemplate that a security interest may be granted in after-acquired property, *i.e.,* collateral acquired by the debtor after the

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[6]The substitution of collateral argument discussed in part III D of this Brief *infra* may be thought of as raising a question as to the existence of the sixth as well as the fifth element. *But see* note 7.

[7]A finding that the transfer was for an antecedent debt means that the creditor was unsecured at the time of the transfer and therefore in the same class as the other creditors of the estate. On the other hand, where the creditor is secured at the time of the transfer, the release of the security provides present consideration for the transfer. *Cf.* Seligson, *The Code And The Bankruptcy Act: Three Views on Preferences And After Acquired Property,* 42 N.Y.U.L. Rev. 278, 294 (1967).

making of the agreement. But §9-204(1) provides that the interest "attaches" to the collateral—that is, it arises or is created—when the *last* of the following events has occurred: First, the parties must agree that the security interest attach; second, value must be given; and third, the debtor must have rights in the collateral. Section 9-204(2)(d) expressly provides that a debtor has no rights in an account until it comes into existence. Furthermore, if the perfection step such as the filing of the financing statement has occurred previously, perfection takes place when the security interest attaches, and not at the earlier point of filing. §9-303(1).

When these Code provisions are related to the elements of a preference, it becomes plain that Rose City's security interest in the after-acquired accounts of the bankrupt is preferential to the extent that it attached to accounts coming into existence within the four months preceding bankruptcy. The transfer occurred not when the parties signed the security agreement and filed the financing statement in November 1963 [C. Tr. 44], but only as the accounts actually arose between June 15, and October 15, 1964. On the other hand, the loans secured by those accounts were made by Rose City no later than November 1963 [Ex. 17; C. Tr. 95; See discussion at Part III B1 of this Brief, *infra*]. The elements involving the four months' period and the antecedent indebtedness thus are demonstrably present.

B. Despite Section 9-108, the Transfer to Rose City of a Security Interest in the Debtor's Collateral Was for an Antecedent Debt.

The draftsmen of the Code did not overlook the potentially preferential nature of a security interest in after-acquired property. Their effort to overcome the problem is §9-108:

> "*When after-acquired collateral not security for antecedent debt.* Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

Judge Solomon believed that this provision saved Rose City's security interest, relying to a considerable extent on a similar ruling in *Rosenberg v. Rudnick*, 262 F. Supp. 635 (D.Mass. 1967). We submit that reliance on §9-108 was erroneous; first, because it is inapplicable to Rose City's loans by its own terms, and second, because the attempted application conflicts with §60 of the Bankruptcy Act.

1. Section 9-108 Is Inapplicable by Its Own Terms.

Section 9-108 on its face does not apply unless the security interest in the after-acquired collateral is granted at the time the creditor "makes an advance, incurs an obligation, releases a perfected security in-

terest, or otherwise gives *new value* . . ." While the term "new value" is not defined in the Code, it, like much of Article 9, derives from the Uniform Trust Receipts Act. §9-402, comment 2. Under that former law, "new value" was defined so as to expressly exclude "extensions or renewals of existing obligations . . . [and] obligations substituted for such existing obligations." Uniform Trust Receipts Act, §1(c); O.R.S. §73.010(7) (repealed 1963).

The security interest granted to Rose City in after-acquired accounts was not given for "new value." The security agreement upon which Rose City relies was made November 22, 1963 [Ex. 17]. Yet of the total principal obligation of $53,122.26 owing to this creditor at bankruptcy, at most the sum of $10,300 was loaned on the day of the agreement. Even on the facts as stated by Judge Solomon, the remaining $42,-822.26 represents the unpaid balance of a loan made about one week earlier on November 16, 1963 [C. Tr. 95]. In reality, however, the record leaves no doubt that to a large extent the two notes dated November 16 and 22 represent a consolidation of several previous advances made on an emergency basis over a period of time to meet payrolls, taxes and other expenses.[8] Thus, the agreement of November 22, 1963 was an attempt to secure Rose City on what was then, at least in great measure, unsecured, antecedent indebtedness. The new value requirement of §9-108 simply did not exist.

[8]The controller of the Reporter testified that the two notes of November 16 and 22, 1963 represented consolidations of the unpaid balances of advances made by Rose City over an extended period of time between March 2, 1962 and November 5, 1963 [R. Tr. 28]. But *cf.* the testimony of the President of appellee [R. Tr. 236-237].

2. The Attempted Application of Section 9-108 Conflicts With Section 60 of the Bankruptcy Act.

Even if §9-108 does apply, the validity of the section is immediately suspect because it is aimed directly at the Bankruptcy Act. Although the Official Comments state that the section "is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable as preferences," it is hard to escape the conclusion that §9-108 was designed solely with §60 in mind. *E.g.,* Gordon as reprinted in COOGAN ET AL., note 3 *supra* at 1172-1177. Recognizing the supremacy of federal law, partisans of the Code strive to demonstrate a consistency between the two statutes, and the District Judge below was so persuaded.

One argument that is made, although Judge Solomon apparently did not directly accept it, is that because the Bankruptcy Act fails to define antecedent debt, the term is left for permissible definition by the states. §9-108, Comment 1. This position is fallacious. The clear meaning of antecedent debt as used in §60 is that the indebtedness of the bankrupt was incurred prior to the time of the questioned transfer. The only element of a preference for which §60 looks in part to state law is the time of the transfer—the date on which it became perfected as against levying creditors, if that date is subsequent to the actual transfer. *E.g.*, 3 COLLIER ON BANKRUPTCY, §60.39 at 960 (14th Ed. Moore 1967). If the debt was incurred before the time of the transfer as so determined, it is antecedent as a federal matter. That the preference statute has its own notion of what is antecedent clearly appears in §60a(7), permitting a limited relation back under special circumstances.

E.g., Kennedy, Note 3 *supra,* at 542-543, 547 n. 125. It has been shown earlier that the transfer of after-acquired accounts occurs under the Code when they come into existence. A loan made before the accounts arise is factually not new value, and any attempt of §9-108 to make it fictionally so is ineffective as beyond the power of state law. 3 COLLIER ON BANKRUPTCY, ¶60.51A at 1050.16-1050.17 (14th Ed. Moore 1967).

Judge Solomon seems to say that while the definition of antecedent debt is a matter of federal law, that law should be determined with reference to "good business practice"; that since leading scholars and businessmen participated in drafting and sponsoring §9-108, and nearly all American jurisdictions have enacted it, the section truly is a guide to the federal meaning of antecedent debt. We believe such reasoning is unpersuasive. It implies that before the Code was widely accepted a loan to be secured by after-acquired collateral was an antecedent debt when the collateral came into existence, but after the Code it is not. And this change occurred without action by Congress, and with respect to an element of §60 not left to state law.

Far from generally accepting state policy in the determination of the elements of a preference, the 1938 Chandler Act version of §60, as refined in the amendments of 1950, rejected the then current state policy. A primary purpose of the 1938 amendments to §60 was to defeat the so-called equitable lien and the doctrine of relation back *e.g.,* 3 COLLIER ON BANKRUPTCY, ¶60.50 (14th Ed. Moore 1967), no matter how many states or businessmen recognized them. *Cf. Corn Exchange National Bank & Trust Co. v. Klauder,* 318 U.S. 434, 437-438, 63 S. Ct. 479 (1943).

One of the decisions the Chandler Act intended to reverse was *Sexton v. Kessler,* 225 U.S. 90, 25 S. Ct. 306 (1912). *Cf.* H. R. Rep. No. 1293, 81st Cong., 1st Sess. 6 (1949). The bankrupt, a New York brokerage firm, had agreed to set aside certain securities as collateral for amounts it might owe one of its creditors from time to time. The securities were segregated in the bankrupt's vault, specially marked with the creditor's name in an escrow package. On occasion, the bankrupt would substitute new securities for the ones originally placed in the escrow, but all substitutions were entered in the records. Several years later, the bankrupt's condition being shaky, the creditor demanded and obtained possession of the escrow securities, and bankruptcy followed shortly thereafter. The Supreme Court held the transfer non-preferential, reasoning that despite the delivery of possession on the eve of bankruptcy, the creditor's rights or equitable lien in the collateral dated under New York law from the original agreement; the transfer was thus outside the four-months period.

As noted, §60 was amended by the Chandler Act to nullify this state law concept of a transfer's relating back to a date earlier than it had actually occurred. In form, §9-108 of the Code relates the original consideration or a new value forward to the date the security interest attaches to after-acquired property. It says, as applied to Rose City's claim, that loans made no later than November, 1963 are new value for security interests attaching to accounts as they arise after June 15, 1964. Is this not the same as relating the attachment of the security interest back to the giving of new value? The result cannot be reconciled with §60's purpose as it has existed since at least 1938.

Judge Solomon's conclusion that a reconciliation was possible apparently was influenced by several other arguments. He referred to the fact that the Code's security interest in after-acquired collateral is not a secret lien because of the filing requirement. Secret liens, however, are only one of the things that the Chandler Act denounced. The equitable lien in *Sexton v. Kessler* was not a concealed one. The pledged securities there were segregated and marked, and anyone examining the bankrupt's vault could have determined the creditor's interest. Similarly, the 1938 amendments intended to reverse cases such as *Thompson v. Fairbanks,* 196 U.S. 516, 63 S. Ct. 682 (1905), involving the perfection within the four-months period of a mortgage of after-acquired property, although the mortgage was recorded. *E.g.,* Hearings on H. R. 6439 Before House Committee On The Judiciary, 75th Cong., 1st Sess. 120-125 (1937); McLaughlin, *Aspects Of The Chandler Act Bill To Amend The Bankruptcy Act,* 4 U. of Chi.L.Rev. 369, 393 (1937). There was no vice of secrecy in the lien on after-acquired collateral involved in *Eberly v. Dudley,* 314 F. 2d 8 (9th Cir. 1963), which this Court invalidated under the 1950 amendments to §60 despite recordation of the mortgage. *Cf. Corn Exchange National Bank & Trust Co. v. Klauder,* 318 U.S. 434, 63 S. Ct. 479 (1943) (involving an assignment of accounts receivable under supervision of a creditors' committee). *See also* Kennedy, note 3 *supra* at 543, n. 107. We submit that §9-108 cannot survive merely on the ground that a Code security interest does not involve secrecy.

Judge Solomon also observed that §9-108 applies only if the debtor acquires the collateral in the ordinary

course of business, from which he reasoned that it did not permit the secured party to improve his position as against other creditors during the crucial period before bankruptcy. Thus, the section could be reconciled with federal policy, for it merely embodies a substitution of collateral doctrine. We submit again that there is fallacy here. Section 9-108 clearly is not limited to situations where there is a true substitution of collateral, as this example shows: About four months before bankruptcy, the debtor borrows $50,000 on the security of all his present and future accounts receivable. If, because of the seasonal nature of the business or otherwise, the balance of existing accounts is low, the creditor is virtually unsecured at the time of the loan. During the next four months, the debtor fills his customers' orders in the ordinary course of business, so that at bankruptcy—just before Christmas, when the bulk of the inventory has been shipped—the accounts receivable aggregate $50,000 or more. Section 9-108, if applied, would validate the attaching of the security interest to the accounts as being for new value.

What has happened, however, is that inventory and other assets available to all creditors ratably have been converted within four months of bankruptcy into a type of asset which is subject to a special claim of the secured party. Yet realistically he was only a general creditor at the time he made the loan. With all deference to Judge Solomon, this is an improvement of position which §60 plainly would not permit. The or-

dinary course of business requirement of §9-108 may prevent its use to effect bad faith preferences, but §60 also prohibits those preferential transfers which are made as a matter of routine and with completely good intentions.

As is discussed below, a true substitution of collateral of equal value is not preferential within the meaning of §60, since such an exchange of collateral involves present consideration rather than antecedent debt. To the extent that §9-108 merely embodies this principle it can be squared with federal law. On the other hand, to the extent §9-108 characterizes as new value something that otherwise would be antecedent under §60, the statutes collide.

We will discuss in the next portion of this Brief two further theories adverted to by Judge Solomon in reconciling §9-108 with the Bankruptcy Act. Basically, both assert that Rose City's security interest involved a transfer which occurred more than four months before bankruptcy. To the extent of their validity and relevance to §9-108, the theories make it possible to avoid a conflict with §60. But the point is this: §9-108 cannot stand on its own and it adds nothing to the secured party's case. *E.g.,* Friedman, note 3 *supra* at 215, 219-220; Seligson, note 7 *supra* at 298. Its validity must depend on the development of some theory which independently can insulate the security interest from the preference section.

C. Notwithstanding the "Res" and "Lien Creditor" Theories, the Transfer to Rose City of a Security Interest in the Debtor's Accounts Occurred Within Four Months of Bankruptcy.

1. The Res Theory.

What has variously been called the "res", "entity", or "Mississippi River" theory conceives of receivables or inventory collateral as a single entity, separate and distinct from their component items—just as the Mississippi River is an entity distinct from the drops of water within its banks at any given moment. From this premise it is argued that the debtor has at all times a present interest in the totality of his inventory and receivables, including the future as well as existing components, so that the creation of a security interest in all the collateral really occurs at the time the security agreement is made and value is given. *E.g.,* Friedman and Henson, note 3 *supra; cf. Manchester National Bank v. Roche,* 186 F. 2d 827 (1st Cir. 1951). Thus viewed, the transfer to Rose City of a security interest in the debtor's future accounts took place in November 1963, well before the four months' period began.

We submit that Article 9 does not adopt this *res* theory, nor is §60 consistent with it. Concededly, one feature of the theory is present in the Code, namely, the rule that a security interest will automatically attach to after-acquired collateral as it comes into existence without the necessity for any further steps.[9]

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[9]Section 9-303(1). In this respect, the Code significantly changed the prior law in many states. Under pre-Code law, possession or some other affirmative step was frequently required to perfect a chattel mortgagee's lien on after-acquired property. *E.g.,* Friedman, note 3 *supra,* at 199; Riemer, note 3 *supra* at 65.

But this is not a sufficient basis for the conclusion contended for by the theory's proponents. We cannot disregard §§9-204(1) and 9-204(2)(d) which expressly provide that the security interest does not attach until the debtor has rights in the collateral and that a debtor has no rights in accounts until they arise. Indeed, the Official Comments to §9-204 seem to expressly reject the concept of a transfer of a *res* at an earlier point:

> "A security agreement may be executed and value given before the debtor acquires rights: the security interest will then attach under subsection (1), as to after-acquired property, when he does." Comment 4.

Moreover, if the drafters of Article 9 had contemplated an earlier transfer of the *res,* there would have been no need for §9-108.[10] The function of this provision is to relate the consideration forward in time to the point when, contrary to the *res* theory, the drafters conceived the security interest in after-acquired property would pass to the secured party.[11]

We now turn to a somewhat more sophisticated version of the *res* theory which views the secured party

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[10]*Cf.* Mr. Friedman's suggestion that §9-108 be amended to provide that upon the conditions now stated the security interest "shall be deemed a present transfer of a present expectancy interest in the future property of the debtor. . . ." Friedman, note 3 *supra,* at 224.

[11]It might be noted in passing that advocates of the *res* concept do not seem to urge it with respect to collateral other than receivables and inventory. But if it is valid at all, there appears to be no sound reason why fixed assets such as machinery and office equipment should not also be considered as entities. Certainly it would be apparent that a creditor with a security interest in equipment, who makes no new advances and who releases no collateral, receives a preference to the extent the debtor buys new machinery within the four-month period.

as having a continuously perfected security interest in after-acquired accounts as the proceeds of a previous interest in contract rights or general intangibles. An "account" as defined in Article 9 represents a receivable which has been earned; it is a right to payment for goods sold or leased or services rendered, not evidenced by an instrument or chattel paper. §9-106(1). A "contract right" means a right to payment under a contract not yet earned by performance. §9-106(2). If the contract is one for goods or services, the contract right ripens into an account as soon as performance takes place. A debtor has a present interest in a contract right as collateral when the contract is made, §9-204(2)(c), so that it can be transferred at this point despite the fact that it will not mature until later. The perfected security interest then shifts onto the account which arises as proceeds of the contract right. §9-306(1). Thus, §9-204(1)'s requirement that the debtor have "rights in the collateral" is said to be met when the security agreement is made, for it refers not to the point in time when the receivable is earned and becomes an account, but rather to the time when the debtor acquired rights in the collateral in its earlier form as a contract right. *E.g.*, Coogan and Bok as reprinted in Coogan Et Al., note 3 *supra,* at 1398. Taking one more step, perhaps, the debtor's business as a going concern can be considered a "general intangible," the catch-all category of collateral. §9-106(3). The result is that the debtor could create a present security interest in this type of collateral even before the contract right came into existence. The *res* thus becomes all encompassing. See II Gilmore, note 3 *supra,* at 1306-7.

Whatever merits this more sophisticated *res* theory may have as a matter of Code interpretation, it cannot serve to save Rose City's security interest. In the first place, the record does not show that the accounts in which Rose City claims a security interest arose under pre-existing contracts. There is some basis for the argument that a binding contract embodying mutual obligations, albeit executory on both sides, is enough of an existing asset to be the subject of a present transfer. But certainly the case is different if there is no underlying enforceable contract, and the future account is merely an expectancy until it is earned.

Secondly, although Rose City's security agreement with the bankrupt's predecessor covered contract rights as well as accounts, it did not purport to cover general intangibles [Ex. 17]. More importantly, the financing statement described the collateral merely as "accounts receivable." [Ex. 3].[12] It goes beyond charitable construction to suggest, as one of the briefs did below, that this designation on the public record might include contract rights (or general intangibles if the deficiency in the security agreement itself is ignored). Until the accounts actually arose, any conceivable security interest in contract rights or general intangibles as a *res* remained unperfected and subject to levy. Therefore the only transfer upon which Rose City can rely occurred within the four months' period.

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[12]Recognizing that §9-204 clearly sets forth the point of time at which the debtor's hypothesized present interest in future receivables becomes "accounts," even the strongest proponents of the theory do not suggest that a perfected security interest in "accounts" would be sufficient to cover what is viewed as the debtor's present interest in a "general intangible." II Gilmore, note 3 *supra*, at 1305-1307.

But regardless of its validity under the Code or its applicability to the present case, there is a more fundamental infirmity in the *res* theory, namely, that it cannot be reconciled with §60 of the Bankruptcy Act. The first element of a preference requires that there be a transfer of the debtor's property. The difficulty with the *res* theory in this connection involves the notion of what is "property." Absent conflict with the Act, state law may well be relevant to the question. But to achieve its policy of a fair and equitable distribution of the bankrupt's estate,[13] §60, just like certain other sections of the Act, must embody its own basic concept of property. *Cf., e.g., Segal v. Rochelle,* 382 U.S. 375, 86 S. Ct. 511 (1966); *Local Loan Co. v. Hunt,* 292 U.S. 234, 54 S. Ct. 695 (1934); *Chicago Board of Trade v. Johnson,* 264 U.S. 1, 44 S. Ct. 232 (1924). Were this not the case, a state could defeat entirely the goal of §60 merely by redefining what it considers to be "property."

An example may help to illustrate the point: A lender is persuaded to finance a debtor who is first beginning his business. At the outset there are no existing assets, although the debtor may have binding contracts to supply certain customers. The lender advances cash of $10,000, taking a security interest in all of the inventory and receivables which will be generated in the future. Sophisticated theories aside, the lender is truly unsecured as a practical matter at the time of the loan. Bankruptcy ensues four months later at which time the debtor has inventory and accounts receivable of $10,000. Even if state law recognized and

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[13]See 3 Collier on Bankruptcy, ¶¶ 60.01, 60.06 (14th Ed. Moore 1967).

enforced a present property interest in future inventory and receivables which could be fully transferred at the time the loan was made, we submit that §60 would defeat the lender. Both its language and spirit would plainly require a ratable distribution of the available assets among all the creditors.

When applied to the foregoing hypothetical case, it is clear that a theory that asserts a debtor has presently transferred property which as a practical matter is not yet in existence suffers from the same vice as the relation back doctrine abolished by the Chandler amendments. In effect it would insulate an otherwise preferential transaction by relating back the realistic time of the transfer to the date the parties agreed that it should occur. This kind of "transfer of property" is too similar functionally to a mere promise to give security in the future to avoid the impact of the present preference section. Thus, §60, like the Uniform Commercial Code but also independently of it, would seem to require that the debtor have rights in the collateral before the transfer can take place.

To some extent, *Rockmore v. Lehman,* 129 F. 2d 892 (2nd Cir. 1942) reversing 128 F. 2d 564, is arguably inconsistent with what has just been said. There the Second Circuit upheld as against a preference challenge a secured party's rights in monies earned within four months of bankruptcy, where the underlying contract had been assigned outside the crucial period. The court relied on applicable New York law which recognized a present assignment of existing but unmatured contract rights. As has been seen, the present case does not necessitate a reconsideration of *Rockmore v. Lehman,* for Rose City never had a perfected security

interest in contract rights under the Code, if indeed such rights even existed. On a proper record, however, we submit that the Second Circuit's decision is questionable. It focused only on the assignment of the contract as the transfer at issue. It did not consider whether transfers occurred for the benefit of the assignee-creditor when, during the four months' period, the debtor made the assigned right more valuable by delivering merchandise or rendering services to the other party to the contract. Finally, the opinion did not deal with whether the broad *res* theory for which it is cited is compatible with the policy of §60.

2. The Lien Creditor Theory.

Like the *res* theory, the lien creditor theory asserts that the transfer of after-acquired collateral occurs at the time the parties make their security agreement and file a financing statement. Here, however, the rationale is that the filing of the financing statement operates to insulate the security interest in the collateral from attack by any subsequent levying creditor, and thus the requirements of §60a(2) have been met. At this point in time, the transfer, in the language of the section, is "so far perfected that no subsequent lien upon property by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." *E.g.,* King, Lawrence, *§9-108 of the Uniform Commercial Code: Does It Insulate the Security Interest From Attack by a Trustee in Bankruptcy?* 114 U.Pa. L.Rev. 1117, 1131-1133 (1966). Another way of putting it is that from the time of filing, the secured party has a fully perfected "legal" lien on all of the after-acquired property not yet in existence. *E.g.,* Friedman, note 3 *supra,* at 199-200, 215.

Judge Ford in *Rosenberg v. Rudnick,* 262 F. Supp. 635 (D. Mass. 1967), adopted this theory as one of the grounds for his decision. While it is not as clear, Judge Solomon also may have been influenced by this view.

Judge Ford distinguished between perfection under the Code, which, as discussed above, cannot occur before the security interest attaches, §9-303(1), and perfection as against a judicial lien creditor under §60a(2) for the purpose of a preference. This distinction, however, seems questionable. We submit that to the extent it is applicable at all, §60a(2) looks to state law—here §9-303(1)—for the time of perfection as to levying creditors; that, accordingly, a Code security interest cannot be perfected for preference purposes until it arises, though there may be no instant in time when a levying creditor could defeat the secured party.

More fundamentally, the lien creditor theory involves the same fallacy as was pointed out with respect to the *res* theory. Section 60 embodies its own minimum concept of "property." Regardless of state law, the time of the transfer of a security interest cannot occur before the debtor acquires rights in the property. The sole function of the lien creditor test of §60a(2) is to postpone to a later date the time of a defective transfer which actually had already taken place.[14] It

[14] As stated by Professor Kripke: "The Bankruptcy Act, even though it does not expressly state a concept of rights in the property as a prerequisite of the lien creditor test of §60a, obviously must apply such a concept. There cannot be perfection until the debtor has rights in the property, and the bankruptcy test operates only to postpone the perfection after that date." Krause, Kripke and Seligson, *The Code And The Bankruptcy Act: Three Views On After-Acquired Property,* 42 N.Y.U.L.R. 278, 289-290 (1967); *see also* Gordon *reprinted* in Coogan Et Al., note 3 *supra,* at §11.08, pp. 1188-1191; Seligson, *The Newspaper Publishing Case,* 42 REF. J. 5, 8 (1968).

is not intended, as Judge Ford applied it, to relate backwards in time an actual transfer of the debtor's property merely because the perfection step occurred first.

This is especially clear in the case of a preference by way of outright transfer of a debtor's property which was never reachable by judicial process. If a debtor paid an unsecured creditor just before bankruptcy by assigning a receivable at the very moment it became owing, or by transferring a nonexempt asset which is not subject to levy under state law, no lien by judicial proceedings could ever have reached the subject of the transfer, but the transaction would nevertheless be potentially preferential. In both of these cases, it would be said that since no further perfection step was required, the transfer occurred under §60a (1) when it took place in fact, and any inquiry under §60a(2) as to the rights of a lien creditor would be irrelevant.

D. The Transfer to Rose City Cannot Be Sustained on a Substitution of Collateral Theory.

Where a secured creditor releases valid collateral in a contemporaneous exchange for new collateral of equal value, there is no preference even though the substitution takes place within the four months' period. 3 Coloier on Bankruptcy, Paragraph 60.21 (14th Ed. Moore 1967). The result is sometimes explained on the ground that in such a transaction no diminution of the bankrupt estate occurs. In terms of the statutory elements of a preference discussed above, it can be said that this kind of substitution does not involve an antecedent debt, that is, the release of old

security is contemporaneous consideration for the new collateral; or, that under these circumstances the transfer of the new collateral to a secured party is not made to a creditor of the same class as others. On the other hand, if the substituted new collateral is more valuable than the old, or if the security interest in the old collateral was for some reason invalid as to creditors or the trustee, or if the debtor had dissipated or disposed of the old collateral before it is replaced by new security, then the substitution is preferential. *Ibid.* In these cases, the alleged consideration provided by the release of collateral is illusory.

We submit that Judge Solomon's application of the substitution of collateral theory to sustain Rose City's security interest in the after-acquired accounts was erroneous for several reasons.

In the first place, he seems to have taken the four months' period as a unit, comparing the aggregate of the new or substituted accounts with an aggregate of the releases or collections by the debtor. This is an improper approach, for each new transfer must be matched against a contemporarneous or subsequent release. *Cf. Cooper Petroleum Company v. Hart,* 379 F. 2d 777, 780-782 (5th Cir. 1967). Assume, for example, that four months before bankruptcy a creditor is secured by $50,000 of accounts. If the debtor, rightfully or wrongfully, disposes of the collateral or dissipates the proceeds, thus making the creditor temporarily unsecured, a subsequent replacement of $50,000 of new accounts will be preferential, despite the fact that during the period considered as a whole the collateral released and that substituted are equivalent. *Cf. Wolfe v. Bank of Anderson,* 238 Fed. 343 (4th

Cir. 1916). Whether a particular transfer results in the diminution of the estate must be tested on an individual basis.

In re Pusey, Maynes, Breish Co., 122 F. 2d 606 (3rd Cir. 1941), was relied upon in the opinion below as justifying an application of the substitution of collateral principle. The facts of that case, however, make it distinguishable from the present one. The debtor had assigned receivables to a bank as security for a loan, under an agreement requiring the debtor to deposit collections in a special account subject to the bank's control. As the debtor assigned new accounts satisfactory to the bank, the latter released to the debtor equivalent sums from the special deposit. The Third Circuit rejected the trustee's argument that the assignment of new accounts within the four months' period was preferential. It pointed out that the releases of collateral from the special deposit coincided with or occurred after the transfer of new accounts. That is, the bank's security was not allowed to dissipate and the claim did not become unsecured before the collateral was replaced.

The *Pusey* opinion specifically distinguished the situation present in Rose City's case. Here no control was maintained over the collections by the debtor. At the beginning of the period Rose City had a security interest in accounts then existing. With minor exception, all this collateral was collected and used by the debtor or became uncollectible before bankruptcy. The non-preferential security interest thus was lost no later than the moment the proceeds were commingled in the debtor's general bank account and became unidentifiable. *Cf.* §§9-306(2), (4). The subsequent arising of

new accounts accordingly became preferential. It should go without saying that later release of any such preferential accounts, being invalid as to the trustee, could not provide a basis for further application of the substitution of collateral doctrine. 3 COLLIER ON BANKRUPTCY, ¶60.21.

The argument that a financing arrangement such as Rose City's is similar to the *Pusey* situation is based on the fact that the Code abolishes the dominion and control rule of *Benedict v. Ratner,* 268 U.S. 353, 45 S. Ct. 566 (1925). *E.g.,* II GILMORE, note 3 *supra* at 1315-1316; Kripke, note 14 *supra* at 287-288. In that case, the bankrupt had assigned its present and future accounts receivable as security for a loan but was permitted to collect and use the proceeds in the operation of its business. Until the lender made demand, there was no requirement that the bankrupt account for or apply the proceeds to repayment of the secured obligation. The Supreme Court, as a matter of applicable New York law, held the arrangement fraudulent; a debtor could not validly make a transfer or create a lien while retaining dominion or control over the property transferred.

Section 9-205 of the Code changes this doctrine. It can do so without conflict with the Bankruptcy Act because *Benedict v. Ratner* involved an interpretation of state law. It is further true, as *Pusey* holds, that by carefully policing the collateral, releasing old accounts or the proceeds only as new receivables come into existence and are substituted, the preference problem can be avoided. Judge Solomon took the further step of concluding that the abolition of the dominion and control rule also made it possible to leave the debtor with

unfettered control of the collateral without running afoul of §60.

The fallacy in such a deduction is that *Benedict v. Ratner* did not deal with the substitution of collateral principle, and its reversal by §9-205 does not, indeed could not, change the conditions which must be met to make the principle applicable under §60. The preference section embodies an overriding federal policy decision that no creditor should be allowed to improve his position at the expense of other creditors at any time during the four months preceding bankruptcy. Only when a creditor can show that there has been a true substitution of collateral is that policy not offended. Thus, replacement of new collateral must precede or be simultaneous with release of old security, or a preference occurs. If the release occurs first, the creditor becomes unsecured and even a short delay in replacing the collateral is fatal under §60. In *National City Bank v. Hotchkiss,* 231 U.S. 50, 34 S. Ct. 20 (1913), for example, a bank which advanced money to a brokerage house in the morning was held to have received a preference when the loan was collateralized later the same day.

It follows that §9-205 does not make Rose City's situation analogous to *Pusey.* While there may be exceptions—particularly in cases where the security consists of relatively few items which do not change rapidly—a secured party who fails to police his collateral probably will be unable to demonstrate that the releases of collateral occurred at the requisite points in time.

In the trial before the Referee in Bankruptcy in this case, there was little if any evidence produced which would support an application of the substitution of col-

lateral theory. After Referee Snedecor's decision, but before the matter was presented to Judge Solomon on review, a stipulation was entered into setting forth the daily balances of the aggregate of the bankrupt's accounts receivable during the four months' period [Ex. 39]. From this data the substitution theory was argued to Judge Solomon. It was contended that the total outstanding receivables never fell below the amount needed to cover Rose City's claim of $53,122.26. Since new accounts came into existence on a daily basis in sufficient amounts to cover the old collateral collected and released, it is said to follow that the attaching of the security interest to new accounts necessarily preceded or was contemporaneous with the release of old ones to the extent necessary to protect Rose City's secured position.

The argument, however, lacks validity for a number of reasons. Some of the difficulty stems from the fact that the daily figures embodied in the stipulation represent raw data from the bankrupt's books which was not sifted through the fact-finding process of a trial court. The figures need further interpretation or clarification if they are to be meaningful at all. Thus, it has been argued that the daily credits shown in Exhibit 39 represent actual collections of accounts, *i.e.*, proceeds released to the bankrupt. Yet we do not know that this is so; it is entirely likely that to some extent at least the figures in the credit column reflect the writeoff of uncollectible accounts or the issuance of credit memos. Obviously, there is no release of collateral in substitution, no present consideration for the new accounts, if the credits do not reflect actual collections.

Moreover, the figures do not show the account balances during any given day; the books apparently show balances only at the end of a day. But this may be important, since, as seen above, a period as short as one day between the making of the loan and the giving of security can result in a preferential transfer.

Another difficulty is that the stipulation reflects gross totals of all receivables, without particularizing the amounts assigned to Rose City. The inadequate itemization is a problem since there was excepted from the assignment to Rose City those accounts which the debtor had assigned to R. Anthony DuBay and Robert J. Davis. Even if the transfers to DuBay and Davis are invalid, as both the Referee and Judge Solomon held, it is far from clear that either the debtor or Rose City intended those accounts to be security for Rose City's claim. On the contrary, there is evidence that the parties meant Rose City to have only those accounts not designated in the lists of receivables prepared for DuBay and Davis.[15]

This question becomes even more significant in light of the failure of Exhibit 39 to reflect the real value of

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[15]The *Reporter* executed agreements wherein it undertook to assign certain of its accounts receivable to DuBay and Davis in July, 1962 and November 30, 1963, respectively [Exs. 15, 16]. Attached to each of those security agreements was a list of certain named account obligors. *Ibid.* Testimonial evidence would seem to establish that the parties intended Davis and DuBay to have all accounts which became owing at any time from those named account obligors [R. Tr. 86, 88-90, 94, 155]. At various times, including April 21, 1964, new lists of account obligors were prepared. [R. Tr. 155, 88-90]. While the courts below held the procedure invalid, the uncontradicted testimony is that in preparing the new lists the Reporter intended to comply with the DuBay and Davis agreements [R. Tr. 41-44], and that Rose City was intended to be secured only by those accounts not transferred to DuBay and Davis [R. Tr. 220-223].

the accounts, as distinguished from their book value, as of the beginning of the four months' period. The substitution theory requires that the collateral released be of at least equal value to that substituted for it. If the accounts assigned to Rose City as of the beginning of the period were worthless, or if they later became uncollectible, substitution of new accounts would be preferential. 3 COLLIER ON BANKRUPTCY, ¶60.21 at 864-5.

There is evidence that, in fact, the real value of the accounts assigned to Rose City was far less than the face amounts shown on the bankrupt's books. The book value of the accounts was $141,000 on September 28, 1964, and approximately $70,000 was billed thereafter [Ex. 39]. Yet of this total, the trustee was able to recover only a gross amount of approximately $127,000, and a net of only $107,000 after collection costs [Ex. 27].

It would thus appear that the bankrupt's accounts included substantial uncollectible items at the end of the business, and there is no reason to believe that the same condition did not exist during the preceding four months. Particularly since it is undisputed that the best accounts were to have been assigned first to DuBay and Davis [R. Tr. 75-76, 220-221, 223, 17, 157], the inference is permissible that Rose City might well have been virtually unsecured on any realistic basis at the beginning of the four months' period. The inability on this record to evaluate the valid security interest at the starting point—indeed, the impossibility of valuation at any time during the period—prevents application of the substitution of collateral theory.

E. The Policy of §60 Requires an Invalidation of Rose City's Security Interest.

It has been argued by some that despite the technical existence of the elements of a preference, §60 should be construed sympathetically in favor of Rose City's claim to the accounts in question because the attaching of its security interest to the after-acquired property did not involve the evils prohibited by §60. *E.g.,* Coogan & Bok, Friedman, Henson, note 3 *supra. But see* Viles, note 3 *supra* at 666-672; Hogan, *Future Goods, Floating Liens and Foolish Creditors,* 17 STAN. L. REV. 822 (1955). This being the case, there should be a reluctance to strike down the widely adopted principles of "good business practice" embodied in Article 9. Judge Solomon made much the same point in finding §9-108 reconcilable with federal law. We respectfully disagree.

Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434, 63 S. Ct. 479 (1943), teaches that §60 must be applied to strike down transfers containing the defined elements of a preference even though the transaction in question does not involve the classic "midnight" transfer or secret lien, or the grab for assets on the eve of bankruptcy.

It has already been shown that the Code's floating lien provisions, insofar as after-acquired collateral is concerned, do involve a relation back effect that §60 is designed to stop. In Rose City's case, there was an even more fundamental violation of the federal policy of equitable distribution. This was not the usual commercial situation where an advance was made on the strength of receivables, with the lender at all times expecting liquidation of the loan from that source. Here repayment of the debt was of secondary importance.

The primary goal, which we do not disparage, was continuing publication of the newspaper as a public service [R. Tr. 108-109]. Indeed, Rose City agreed that DuBay and Davis could take the best accounts [R. Tr. 17, 75-76, 157, 220]; it made no effort to keep track of whether it was realistically secured or not. Only on the occasions when bankruptcy appeared imminent did Rose City assert the rights normally exercised by a secured party.[16] Although the Code's abolition of the rule of *Benedict v. Ratner* means that strict policing of collateral is no longer necessary to avoid the taint of fraud, the policy of §60 does not permit a lender to behave like an unsecured creditor up to the time of trouble, and then to take a secured stance. In any practical sense, this is the forbidden strengthening of position on the eve of bankruptcy.

Finally, we submit that to invalidate Rose City's security interest is not to interfere with "good business practice" or legitimate receivables financing under the Code. Despite §9-205, a prudent lender does supervise and control his collateral, and this is especially true after he has reasonable cause to believe the debtor is insolvent. Coogan et al., note 3, *supra* at §15.09 n. 47; Robinson, *New Value Concept Under the Code*, 73 Banking L. J. 78, 80 (1956); *Cf.* II Gilmore

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[16]On February 26, 1964, the Reporter published a notice that due to a lack of funds it would cease publication on Saturday, February 29, 1964 [R. Tr. 146-147]. By letter dated February 27, 1964, Rose City directed the Reporter to transmit to it all cash proceeds collected from the assigned accounts [Ex. 39]. Upon resumption of publication on March 3, 1964, Rose City released all the proceeds collected and thereafter permitted the debtors to exercise unrestricted control of the collateral [Ex. 39] until after the Board of Directors of the bankrupt resolved that it would permanently cease publication on September 30, 1964 [C. Tr. 5; Ex. 39].

note 3 *supra* at 1340. He does so not only because of the potential problem under §60, but also to prevent loss of the security interest as a result of the debtor's dealing improperly with the collateral or commingling the proceeds so that they become unidentifiable. *Cf.* §9-306. Indeed, the printed UCC Form No. 1208 entitled "Accounts Receivable Loan and Security Agreement," which was actually used by Rose City, provides for a cash collateral account to regulate the debtor's disposition of proceeds [Ex. 17]. The striking of this provision by the parties without imposition of any comparable controls is one more indication that this case did not involve an ordinary financing transaction.

IV.

IF ROSE CITY'S SECURITY INTEREST IS UPHELD, THE CASE MUST BE REMANDED FOR FURTHER PROCEEDINGS.

Since Referee Snedecor held invalid the security interests asserted by all of the competing creditors, it was unnecessary for him to pass upon the trustee's contention that the senior DuBay and Davis claims should be preserved for the benefit of the bankrupt estate. The point became important, however, when Judge Solomon agreed with the Referee as to DuBay and Davis, but reversed in Rose City's case. If that decision is here affirmed in all respects, the question of whether the trustee can preserve or subrogate to the invalidated security interests should be considered. Otherwise, Rose City will receive a windfall as a result of the avoidance of the senior encumbrances.

Moreover, even if the DuBay and Davis interests were found not subject to preservation, there would

remain the unresolved factual issue of whether the contracting parties under such circumstances intended Rose City to have the DuBay and Davis accounts as security. Related accounting and identification problems will arise with respect to the funds collected after September 28, 1964, depending on how the foregoing questions are decided.

Thus, if Rose City's security interest is upheld, additional findings of fact seem necessary and a remand for further proceedings would appear appropriate to that end.

Conclusion.

For the foregoing reasons, the order below should be reversed to the extent it upheld the validity of the alleged security interest of Rose City Development Company, Inc.

Respectfully submitted,

Boyrie, Miller & Long and
Quittner, Stutman, Treister & Glatt,
George M. Treister and
Bruce H. Spector,
Attorneys for Appellant, Trustee in Bankruptcy.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

George M. Treister

APPENDIX.

Statutes Involved.

Bankruptcy Act.

Section 60a(1), (2) (11 U.S.C. §96a(1), (2))

§60. *Preferred Creditors.* a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. . . . [I]f any transfer is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

Section 60b (11 U.S.C. §96b)

b. Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto

has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. . . .

Section 70c (11 U.S.C., §110c)

[The following is the pertinent portion of §70c as it existed prior to the 1966 amendment. The amendment of that year did not change the section in a manner material to the present case.]

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Section 1(30) (11 U.S.C. §1(30))

(30) "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, pay-

ment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor;

Uniform Commercial Code.

Section 9-105 (ORS 79.1050)

79.1050 Definitions and index of definitions. (1) In ORS 79.1010 to 79.5070 unless the context otherwise requires:

. . . .

(c) "Collateral" means the property subject to a security interest, and includes accounts, contract rights and chattel paper which have been sold.

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts, contract rights or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of ORS 79.1010 to 79.-5070 dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires.

Section 9-106 (ORS 79.1060)

79.1060 Definitions: "account"; "contract right"; "general intangibles." In ORS 79.1010 to 79.5070 unless the context otherwise requires:

(1) "Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper.

(2) "Contract right" means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper.

(3) "General intangibles" means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments.

Section 9-108 (ORS 79.1080)

79.1080 When after-acquired collateral not security for antecedent debt. Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

Section 9-201 (ORS 79.2010)

79.2010 General validity of security agreement. Except as otherwise provided by the Uniform Commercial Code a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. . . .

Section 9-203(1) (ORS 79.2030(1))

79.2030 Enforceability of security interest; proceeds, formal requisites. (1) . . . a security in-

terest is not enforceable against the debtor or third parties unless:

(a) The collateral is in the possession of the secured party; or

(b) The debtor has signed a security agreement which contains a description of the collateral. . . . In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.

Section 9-204 (ORS 79.2040)

79.2040 When security interest attaches; after-acquired property; future advances. (1) A security interest cannot attach until there is agreement as defined in subsection (3) of ORS 71.2010 that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

(2) For the purposes of this section the debtor has no rights:

. . .

(c) In a contract right until the contract has been made.

(d) In an account until it comes into existence.

(3) . . . a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement. . . .

Section 9-205 (ORS 79.2050)

79.2050 Use or disposition of collateral without accounting permissible. A security interest is not invalid or fraudulent against creditors by rea-

son of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts, contract rights or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

Section 9-301 (ORS 79.3010)

79.3010 Persons who take priority over unperfected security interest; "lien creditor." (1) . . . an unperfected security interest is subordinate to the rights of:

. . . .

(b) A person who becomes a lien creditor without knowledge of the security interests and before it is perfected.

. . . .

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy, or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. Unless all the creditors represented had knowledge of the security interests such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest.

Section 9-302 (ORS 79.3020)

79.3020 When filing is required to perfect security interest; security interests to which filing provisions of ORS 79.1010 to 79.5070 do not apply. (1) A financing statement must be filed to perfect all security interests except the following:

[none of the listed exceptions is material to this case]

Section 9-303(1) (ORS 79.3030(1))

79.3030 When security interest is perfected; continuity of perfection. (1) A security interest is perfected when it has attached and when all the applicable steps required for perfection have been taken. . . . If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

Section 9-306 (ORS 79.3060)

79.3060 "Proceeds"; secured party's rights on disposition of collateral. (1) "Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are "cash proceeds." All other proceeds are "noncash proceeds."

(2) Except where ORS 79.1010 to 79.5070 otherwise provide, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in

any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected 10 days after receipt of the proceeds by the debtor unless:

(a) A filed financing statement covering the original collateral also covers proceeds; or

(b) The security interest in the proceeds is perfected before the expiration of the 10-day period.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest:

(a) In identifiable noncash proceeds;

(b) In identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;

(c) In identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and

(d) In all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is:

(A) Subject to any right of setoff; and

(B) Limited to an amount not greater than the amount of any cash proceeds received by the debt-

or within 10 days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the 10-day period.

. . . .

Section 9-401(1) (ORS 79.4010(1))

79.4010 Place of filing; erroneous filing; removal of collateral. (1) The proper place to file in order to perfect a security interest is as follows:

. . . .

(c) . . . in the office of the Secretary of State and in addition, if the debtor has a place of business in only one county of this state, also in the office of the county clerk . . .

Section 9-402(1) (ORS 79.4020(1))

79.4020 Formal requisites of financing statement; amendments. (1) A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. . . .

NO. 22509

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

– –

RANK J. EVANS and	)
ARGUERITTE A. EVANS,	)
Appellants,	)
v.	)
OMMISSIONER OF INTERNAL REVENUE,	)
Appellee.	)

APPELLANT'S OPENING BRIEF

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ppeal from the Decision of the Tax Court of the United States, onorable Norman O. Tietjens, Judge. (Decision Reviewed by the ourt).

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Appellee.	)

APPELLANTS' OPENING BRIEF

STATEMENT OF JURISDICTION

1.

Statutory Basis for Jurisdiction

Jurisdiction of the Tax Court of the United States (Tax Court) n this action arose pursuant to 28 U.S.C. 7442, (1964) 28 U.S.C. 212, (1964) and 28 U.S.C. 6213, (1964). Jurisdiction of this ourt is based upon 28 U.S.C. 7482(a), (1964).

2.

Pleadings Establishing Jurisdiction

The Office of the Regional Commissioner of Internal Revenue, ppellate Division, San Francisco, California, issued a statutory

tice of deficiency to appellant dated June 2, 1966, covering e years 1962 and 1963(R.5-10). A timely Petition for Redetermina- on was filed in the Tax Court on June 2, 1966 (R.1-4). Thereafter e Tax Court entered a decision against the appellants on ptember 22, 1967 and appellants filed a timely Petition for view of Decision of the Tax Court on November 14, 1967 (R.90-).

STATEMENT OF THE CASE

1.

Nature of the Controversy

The appellants dispute a deficiency in Federal income tax for e calendar year 1962 in the sum of $41.21, and a deficiency Federal income tax for the calendar year 1963 in the sum $1,089.35; in addition, appellants contend that they are titled to a refund of Federal income tax for the year 1962 the amount of $1,239.63.

The above deficiencies and the claimed-over assessment e occasioned by the appellants' contention that they are entitled o an investment credit for the four utility systems purchased part of a mobile home park in 1962, which had a cost of at ast $12,500 each, or a total of $50,000 for the four systems.

The only issue for determination is whether the appellants e entitled to an investment credit for all or any part of gas distribution system, for all or any part of an electrical ergy distribution system, for all or any part of a water distribu-on system, and for all or any part of a sewage disposal system, l of which were purchased in 1962 as part of a mobile homes rk which was operated by the appellants in 1962 and 1963.

The 1963 deficiency results from the disallowance of a rry-over of unused investment credit arising in the year 1962.

The Tax Court, in Dec. 28.575, 48 T.C.__No. 69 (R.65-80) ld that the appellants were not entitled to the claimed invest-

nt credit, however by virtue of a concession by appellee on
other issue, the decision was entered under Rule 50.

2.

THE FACTS

In the Tax Court, the case was submitted on full stipulation d the court stated at 48 T.C. No. 69 Page 2 (R.66) "All of e facts are stipulated, and are so found. The exhibits and cts are included herein by this reference." The facts as stipula- d are as follows:

"1. Frank J. and Margueritte A. Evans, husband and wife, titioners herein, reside at 890 38th Avenue,Santa Cruz, Cali- rnia. (R.16).

"2. Frank J. and Margueritte A. Evans filed joint income tax turns for the years 1962 and 1963 with the District Director Internal Revenue at San Francisco, California. (R.16).

"3. In 1962 the petitioners purchased a used 111 space mobile mes park, Opal Cliffs Mobile Homes Park, for a total purchase ice of $327,000.00. Of the total purchase price, $143,000.00 the cost of the land, and the balance of $184,000.00 is the st of improvements of which at least $12,500 is the cost of ch one of the four utility systems, namely, a natural gas distri- tion system, an electrical energy distrubtion system, a water stribution system, and a sewage disposal system.(R.16-17).

"4. During 1962 and 1963, the petitioners were engaged in e operation of Opal Cliffs Mobile Homes Park, and in connection erewith, operated the four utility systems in the following nner:

(a) The sewage disposal system required no special atten-ion and the charge for its use to each mobile home owner was made s a part of the monthly charge for space. The system in Opal liffs Mobile HOmes Park is connected to the East Cliff Sanitation istrict and is under the control of Santa Cruz County, California.

(b) The water in Opal Cliffs Mobile Homes Park was sup-lied by the C.L. Beltz Water System, a public utility, operating nder authority from the California Public Utilities Commission, ecision No. 20189. Each mobile home owner in Opal Cliffs Mobile omes Park is charged $2.00 per month for water by the petitioners s part of the monthly charge for space in accordance with the chedule of rates established by the California Public Utilities ommission in their Decision No. 49269 for the sale of water by the .L. Beltz Water System. The petitioners in turn pay the C.L.Beltz ater System at a monthly rate which averages $50 per month.***

(c) The petitioners purchase all of the electrical nergy used in Opal Cliffs Mobile Homes Park from Pacific Gas & .ectric Company, and pay for it at a fixed rate. The petitioners ı turn supply the electrical energy to the mobile home owners in pal Cliffs Mobile Homes Park and bills each mobile home owner ı accordance with the amount of electrical energy used during ne previous month. The petitioners read the meters each month, aintained appropriate records, and billed the mobile home owners or the amount of electrical energy used each month

in accordance with a schedule of rates approved by the California Public Utilities Commission.***

(d) The petitioners operate a natural gas distribution system exactly as outlined in 3(c) (sic) above. (R.17-19).***"

5. The four utility systems have a useful life of twenty years for computing depreciation thereon (R.31).

6. The Federal Income Tax return, Form 1040, filed by the appellants for the year 1962, contained no investment credit (R.20)

7. The amended return, Form 1040 filed by the appellant for the year 1962, contained an investment credit for the four utility systems. The investment credit claimed for the utility systems when coupled with the investment credit for items not in dispute, was $3,696.70 of which $1,152.11 was used to offset the income tax for the year 1962, resulting in an overpayment for that year in the amount of $1,239.63. The refund claimed differs from the investment credit claimed because the net income from the mobile homes park was reduced from $6,657.94 on the original return to $6,215.94 on the amended return, or a difference of $442.00 by adjustments not here in issue. The unused portion of the investment credit from 1962 in the amount of $2,544.59 was carried over to the year 1963 and claimed as a credit to the extent of the full amount of the tax for the year 1963, namely $1,136.34." (R. 31,32,51,57,61 & 62).

STATUTES, REGULATIONS AND CONGRESSIONAL COMMITTEE

REPORTS INVOLVED

1. The Internal Revenue Code of 1954, as amended, as it ppears at 28 U.S.C. 38 (1964)

"Sec. 38. (a) General Rule - There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations.- The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

2. The Internal Revenue Code of 1954 as amended, as it ppears at 28 U.S.C. 46 (c)(3)(1964)

"(3) Public Utility Property.-

(A) In the case of section 38 property which is public utility property, the amount of the qualified investment shall be 3/7 of the amount determined under paragraph (1).

(B) For purposes of subparagraph (A), the term "public utility property" means property used predonimantly in the trade or business of the furnishing or sale of -

(i) electrical energy, water, or sewage disposal services,

(ii) gas through a local distribution system,

(iii) telephone service, or

(iv) telegraph service by means of domestic telegraph operations (as defined in section 222(a)(5) of the

Communications Act of 1934, as amended; 47 U.S.C., sec. 222(a)(5)),

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof."

3. The Internal Revenue Code of 1954, as amended, as it appears at 28 U.S.C. 48 (a)(1)(1964)

"Sec. 48 (a) Section 38 Property.-

(1) In General.- Except as provided in this subsection, the term "section 38 property" means-

(A) tangible personal property, or

(B) other tangible property (not including a building and its structural components) but only if such property-

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or..."

4. 28 C.F.R. §1.46 3(g)(4)(i)

"(4) (i) With respect to properties of a taxpayer engaged in both the production or transmission of gas and the local distribution of gas, section 38 property shall be considered as used predominantly in the trade or business of the

furnishing or sale of gas though a local distribution system if expenditures for such property are chargeable to any of the following accounts under either the uniform system of accounts prescribed for natural gas companies (class A and class B) by the Federal Power Commission, effective January 1, 1961, or the uniform system of accounts for Class A and B gas utilities adopted in 1958 by the National Association of Railroad and Utility Commissioners (or would be chargeable to any of the following accounts if the taxpayer used either of such systems):

(a) Accounts 360 through 363, inclusive (Local Storage Plan), or

(b) Accounts 374 through 387, inclusive *Distribution Plant)."

5. 28 C.F.R. §1.48-1(a)

"Definition of section 38 property.-(a) In general. Property which waulifies for the credit allowed by section 38 is known as "section 38 property". Except as otherwise provided in this section, the term "section 38 property" means property (1) with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the taxpayer, (2) which has an estimated useful life of 4 years or more (determined as of the time such property is placed in service), and (3) which is either (i) tangible personal

property, (ii) other tangible property (not including a building and its structural components), but only if such other property is used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such service, or is a research or storage facility used in connection with any of the foregoing activities, or (iii) an elevator or escalator which satisfies the conditions of section 48(a)(1)(C). The determination of whether property qualifies as section 38 property in the hands of the taxpayer for purposes of the credit allowed by section 38 must be made with respect to the first taxable year in which such property is placed in service by the taxpayer. See paragraph (d) of §1.46-3. For the meaning of "estimated useful life", see paragraph (e) of §1.46-3."

6. 28 C.F.R. §1.355-1(c)

(c) Active business. Section 355 is not applicable unless the controlled corporation and the distributing corporation are each engaged in the active conduct of a trade or business. For specific rules in this connection see section 355(b)(1) and (2). Without regard to such rules, for purposes of section 355, a trade or business consists of a specific existing group of activities being carried on for the purpose of earning income or profit from only such

group of activities, and the activities included in such group must include every operation which forms a part of, or a step in, the process of earning income or profit from such group. Such group of activities ordinarily must include the collection of income and the payment of expenses. It does not include -

(1) The holding for investment purposes of stock, securities, land or other property, including casual sales thereof (whether or not the proceeds of such sales are reinvested),

(2) The ownership and operation of land or buildings all or substantially all of which are used and occupied by the owner in the operation of a trade or business, or

(3) A group of activities which, while a part of a business operated for profit, are not themselves independently producing income even though such activities would produce income with the addition of other activities or with large increases in activities previously incidental or insubstantial.

7. 28 C.F.R. §1.355-1(d) Example 12.

"1.355-1(d) The following examples illustrate the application the rules described in paragraph (c) of this section:

"Example (12). Corporation M is engaged in the manufacture and sale of steel and steel products. In addition, Corporation M owns and operates a coal mine for the sole purpose of

supplying its coal requirements in the manufacture of steel. It is proposed to transfer the coal mine to a new corporation and distribute the stock of such new corporation to the shareholders of Corporation M. The activities of Corporation M in connection with the operation of the coal mine do not constitute a trade or business, since such activities are not themselves independently producing income although a part of the business operated for profit."

8. Technical Explanation of the Bill appended to S. Rept. No. 881, 87th Congress, 2d. Sess. (1962) 1962-3 C.B. 843,859. "Property is to be considered as being used as an integral part of a system of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services only if such property is used by one engaged in the trade or business of furnishing such services."

SPECIFICATION OF ERRORS RELIED UPON

1. The Tax Court's application of 28 U.S.C. 48 (a)(1)(B)(i)
964) is in error in that it requires that a multi-faceted
siness prove the existence of separate and distinct businesses
a condition precedent to the allowance of the investment credit.

2. Assuming for purposes of discussion that a multi-faceted
siness must prove the existence of separate and distinct busi-
sses as a condition precedent to the allowance of an investment
edit for property described in 28 U.S.C. 48(a)(1)(B)(i), (1964),
e Tax Court erred in concluding that appellants were not engaged
a trade or business of furnishing electrical energy, gas,
ter and sewage disposal services.

Questions Presented

1. Whether it was the intent of Congress that the provisions
28 C.F.R. §1.355-1(c) be incorporated into 28 U.S.C 48 (a)(1)
964) as the standard to be applied in questions relating to
e term "***by a person engaged in the trade or business of
rnishing any such service***."

2. Assuming that Question 1 is decided in favor of applying
e provisions of 28 C.F.R. §1.355-1(c) in questions involving
U.S.C. 48 (a)(1), (1964),whether the stipulated facts prove
at appellants were engaged in the trade or business of furnishing
lectrical energy, gas, water and sewage disposal services.

SUMMARY ARGUMENT

The Treasury Department issued interpretive regulations or 28 U.S.C. 46 (C)(3)(1964), Internal Revenue Code of 1954, amely, 28 C.F.R. §1.46-3 (g)(4)(i) which cover the subject f classifying property either as public utility property or roperty other than public utility property. The regulation s to be applied in businesses which operate both public utility nd non-public utility enterprises. These regulations tend o indicate that the stringent requirements of 28 C.F.R. §1.355-(c) need not be met in order to have separate trades or businesses or purposes of 28 U.S.C. 46. Specifically, it appears from 8 C.F.R. §1.46-3 (g)(4)(i) that the requirement in 28 C.F.R. .355-1(c) (as exhibited in 28 C.F.R. §1.355(d) Example 12) hat a group of activities carried on as part of a larger enterprise must themselves independently produce income, is not ncorporated into 28 U.S.C. 46, (1964). Further, it is logical o assume that since 28 U.S.C. 46 (1964) and 28 U.S.C. 48 (a)(1) 1964) are part of a group of sections enacted at the same time o effect the investment credit, Congressional intent, as interpreted by the Treasury Department in their regulations, would be he same for both of those sections (46 and 48), therefore, 8 C.F.R. §1.355-1(c) would have no application in questions nvolving the interpretation of 28 U.S.C. 48 (a)(1) (1964) and he appellants would not be required to prove that they operated he four systems at their mobile homes park separately or at

a profit to qualify for the investment credit. This view, ith some modifications, was expressed in the concurring opinion f Judge Tannewald.

Assuming for purposes of argument that the standards of 8 C.F.R. §1.355(1)(c) are applicable to the situation here, ne appellants meet the test with respect to three of the systems n issue because those systems were independently producing income s is illustrated by the water system which on the stipulated acts could have earned as much as $1,339.00.

ARGUMENT

I. The regulations and legislative history contain no requirement that Congress intended to restrict the investment credit by limiting the credit for property otherwise qualifying under 28 U.S.C. 48(a)(1) (1964) to those instances where an integrated business could prove that the assets in question were operated as a separate business and with a profit motive.

A. The "clearly erroneous facet of Rule 52(a) of the Federal Rules of Civil Procedure is not applicable where the trial court must apply a legal standard to undisputed facts.

In Lundgren v. Freeman, 307 F.2d 104 (CA-9, 1962), the ourt set forth the rule that in those situations where a trial ourt is applying a legal standard to undisputed facts, the onclusion of the trial court with respect to the application f the legal standard is not shielded by the clearly erroneous acet of Rule 52(a) of the Federal Rules of Civil Procedure.

Under the above cited rule, the threshhold question is hether the trial court was applying a legal standard or was rawing inferences from having had "experience with the mainsprings of human conduct".

It is submitted that the question of whether the appellants ere engaged in a trade or business of furnishing electrical nergy, gas, water, and sewage disposal service, involving as

t does terms of art (trade or business) with special meaning n tax law, calls for the application of a legal standard. To ut it another way, experience with the mainsprings of human onduct in and of itself would not qualify a trial court to pply the statute here in question because the statute contains standard with special meaning in tax law.

For the foregoing reasons, the decision of the Tax Court s not shielded by the clearly erroneous facet of Rule 52(a).

B. 28 C.F.R. §1.48-1(a), Income Tax Regulations, which contains the requirement that property used as an integral part of furnishing electrical energy, gas, water, or sewage disposal services, qualifies for the investment credit only if the owner of the property is engaged in the trade or business of furnishing any such service, does not contain a requirement that the trade or business of furnishing those services be separable from the other business activities of the taxpayer.

The controversy in this case arises out of the proper interpre-ation of 28 U.S.C. 48(a)(1)(B)(i) (1964) Internal Revenue Code f 1954) (hereinafter for convenience referred to as the "code ection in issue"). The code section in issue contains no reference o the requirement that the owner of property used as an integral

rt of furnishing electrical energy, gas, water and sewage sposal service (hereinafter for convenience referred to collect-ely as "the four services") be engaged in a trade or business furnishing such services. The requirement that a taxpayer st be engaged in a trade or business of furnishing such service pears in 28 C.F.R.§1.48-1 (a). The validity of the aforementioned gulation was challenged in the Tax Court on the ground that added an additional requirement not found in the code section issue, however, the Tax Court determined that the regulation s a reasonable interpretation of the statute based upon statements de in the Technical Explanation of the Bill, appended to S. pt. No. 1881, 87th Congress 2d Sess.(1962), 1962-3 C.B. 843, 9 (R.73).

The threshhold question which must be answered in applying C.F.R. §1.48-(a) is whether the taxpayer conducting an integrated siness consisting of many facets must be able to prove that he four services" or any one of them constitute a group of tivities which would qualify under the criterion established 28 C.F.R. §1.355-1(c). Without specifically stating that ey were doing so, the Tax Court Judges applied the standards t forth in 28 C.F.R. §1.355-1(c), this fact is recognized d referred to by Judge Tannewald in his concurring opinion -78) when he refers to <u>Edmund P. Coady</u>, 33 T.C. 771 (1960) fd. 289 F. 2d 490 (C.A. -6, 1961).

It is recognized that it is impossible for Congrecs to oresee the many varied circumstances in which a statute will ecessarily have to be applied and to provide minute instructions n the statute itself or as supplemented by statements of its ntent in committee reports. It is, however, reasonable to ssume that Congress in drafting the various related sections hich make up the investment credit had carryover inten- ions with respect to all the related sections which were drafted t the same time.

As a result of the lower rate of investment credit allowed or public utility property by virtue of 28 U.S.C. 46(c)(3), (1964), ll code section citations refer to the Internal Revenue Code of 954), the Treasury Department in interpreting the intent of ongress foresaw that there would be problems in classifying he property of an integrated business which was engaged in perating a public utility. In order to set guide lines for lassifying property owned by such integrated businesses engaged n a public utility activity, the Treasury Department promulgated 3 C.F.R. §1.46-3(g)(4)(i) which states in part as follows:

"With respect to properties of a taxpayer engaged in both the production or transmission of gas and the local distributic of gas, section 38 property shall be considered as used predominantly in the trade or business of the furnishing or sale of gas through a local distribution system if expendi- tures for such property are chargeable to any of the following accounts***".

The importance of this quotation is that it indicates that he Treasury Department, in interpreting the code, recognizes hat differing situations will exist within the framework of he business, however, it does not set forth the elaborate standards ontained in 28 C.F.R.§1.355-1(c) to determine whether separate usinesses exist, likewise does it incorporate those standards n any manner. The complete absence of any standards for determiing whether the utility business is separate from any other ctivity of the taxpayer, would logically tend to indicate that hese sections of the code viz., 38,46,47 and 48 are not to be overned by the strict standards of 28 C.F.R. §1.355-1(c).

One of the examples of the application of 28 C.F.R. 1.355-1(c) is Example 12 in 28 C.F.R.§1.355-1(d) which reads s follows:

"Example (12) Corporation M is engaged in the manufacture and sale of steel and steel products. In addition, Corporation M owns and operates a coal mine for the sole purpose of supplying its coal requirements in the manufacture of steel. It is proposed to transfer the coal mine to a new corporation and distribute the stock of such new corporation to the shareholders of Corporation M. The activities of Corporation M in connection with the operation of the coal mine do not constitute a trade or business, since

such activities are not themselves independently producing income although a part of the business operated for profit".

When Example 12 above is compared with that portion of 8 C.F.R. §1.46 3(g)(4)(i) quoted above, it can readily be observed hat the stringent requirements of 28 C.F.R. §1.355-1(c) are ot applicable to 28 U.S.C. 46 (1964) nor the code section in ssue. To elaborate on the comparison between the two sections f the regulations, there would be different results from their espective application in a situation where a business was ngaged in the production of gas and the gas was marketed olely through a local distribution system. . The production hase of the business would not be considered a separate business nder 28 C.F.R. §1.355-1(c) and (d) Example 12, because those ctivities carried on in the production phase would not themselves e "independently producing income". However, under 28 C.F.R.§1.46 3(g)(4)(i) the production phase of the business would be treated ifferently for investment credit purposes from the local distribution phase of the business.

It is obvious from the above comparison that Congress did ot intend to incorporate into 28 U.S.C. 46 (1964) the stringent equirements set forth in 28 C.F.R. §1.355-1(c), likewise, it ppears logical that in drafting the related code section, 28 .S.C. 48(a), (1964),Congress did not intend to incorporate ithin it the requirements of 28 C.F.R. §1.355-1(c).

For the foregoing reasons it is clear that the Tax Court applied an incorrect legal standard to the undisputed facts in arriving at its decision.

At this point, it would be well to point out that in his concurring opinion, which was acquiesced in by Judge Raum, Judge Tannewald, after indicating a hypothetical situation in which he would allow the credit, stated that the taxpayers in his hypothetical would be entitled to the investment credit - "***whethe or not they operated such systems separately or at a profit***" (R.79).

In one of his hypothetical illustrations (R.79) Judge Tannewald made but one distinction between the operation of three of the systems in the instant case and the hypothetical. The sole distinction was whether the operator of a mobile home park had an inventory. The reference here is to Judge Tannewald's illustration of a taxpayer purchasing and storing bottled gas and then selling the gas to mobile home owners. The facts in the instant case involve electrical energy, gas and water which are not normally stored, therefore, the appellants could never have an inventory, however, it is submitted that if the appellants had been aware of the thinking of Judge Tannewald and had pointed out to him the thinness of his distinction, he would undoubtedly have joined Chief Judge Drennen and Judge Featherston in their dissent.

The correct interpretation of the code section in issue s as stated by Judge Tannewald, that where a taxpayer is "furnihing" electrical energy, gas, water and sewage disposal services s part of a unified or integrated business, the particular axpayer involved is engaged in the trade or business of furnihing such services whether or not such services are operated eparately or at a profit.

In the instant case the mobile home park is a separate ntity economically and geographically, and appellants are engaged n a trade or business of furnishing electrical energy, gas nd water and providing sewage disposal services for the separate conomic and geographic entity as is indicated in the stipulation f facts (R.19-21). In any event it would appear to be a strained onstruction of the statute to hold that the appellants who urchase electrical energy, gas and water at one rate, distribute nese items through their own wholly owned and maintained system, harge, bill and collect from the customers at a higher rate, re not engaged in a trade or business of furnishing any such ervices.

II. <u>The stipulated facts prove that the appellants were engaged in a trade or business of furnishing electrical energy, gas, water, and sewage disposal services</u>.

The stipulation of fact, at 4(b)(R-17) indicates that each f the mobile home owners was charged $2 per month for water

and that the appellants paid $50 per month for the water. Stipulation 3(R-16-17) indicates that the water system cost $12,500.

Based on the aforementioned stipulated facts, the following table indicates the profit to be realized by the taxpayer from the sale of water:

Gross revenue ($2 x 111 x 12 months)		$2,664.
Cost of water ($50 x 12 months)	$600	
Depreciation ($12,500 divided by 20 years)	625.	
Total costs		1,225
Net profit from sale of water		$1,339.

Based upon the foregoing analysis of the stipulated facts, it is clear that the appellants operated the water system at a profit, therefore in accordance with the standards set forth in the Tax Court's opinion, appellants were engaged in the trade or business of furnishing water.

The Tax Court at page 9 of their opinion (R.73-74) state as follows:

"***The stipulated facts merely show that petitioners read meters, maintained the appropriate records, and billed the mobile home owners in Opal Cliffs for the various utilities services used***:. This particular summation of the facts is inaccurate inasmuch as the appellants owned the entire distribution systems for electrical energy, gas and water in the geographical area which made up their mobile homes park, and also owned the sewage disposal system in the geographical area of their mobile homes

ark. This is so stipulated. In addition, it is stipulated
hat the appellants purchased the electrical energy, gas and
ater from other sources and paid for it at a fixed price (R.
7-19). The appellants in turn supplied the electrical energy,
as and water to the mobile home owners in Opal Cliffs Mobile
omes Park and charged them a different rate than that paid by
he appellants.

These activities when taken together, constitute all of
he elements of a trade or business except one, namely, the
rofit motive. The profit motive is clearly exhibited for
he water system, and it is submitted that the stipulated facts
ith respect to the gas and electrical energy systems permit
o other conclusion than that the appellants intended to make
profit from those systems. If there had been no profit motive,
he work involved in maintaining the meters, reading them
onthly and billing each mobile home owner separately would have
een idle acts when it is considered that the appellants could
ave dispensed with those activities.

If the Tax Court had correctly applied the legal standard
hich they selected, their conclusion should have been that the
ppellants were entitled to the investment credit under 28 U.S.C.
(a)(1).

CONCLUSION

The Tax Court applied an erroneous legal standard in ıolding that the appellants were not engaged in a trade or ɔusiness of furnishing electrical energy, gas, water and sewage lisposal services. When the correct standard is applied, it .s readily ascertainable that appellants were engaged in the :rade or business of furnishing the services in question. ıikewise, assuming that the legal standard applied by the Tax Court was correct, the evidence clearly indicates that the ıppellants met the standard.

For the foregoing reasons, the Tax Court decision should e reversed with directions to abate the deficiences and refund he tax, all of which has now been paid.

Respectfully submitted,

NOLAND, HAMERLY, ETIENNE & FULTON

By ______________________
Martin J. May

APPENDIX

Table of Exhibits

Exhibit Number	Received as Evidence
1-A	R. 16
2-B	R. 16
3-C	R. 18
4-D	R. 18
5-E	R. 19
6-F	R. 19

I certify that, in connection with the preparation of his brief, I have examined Rules 18, 19 and 39 of the United tates Court of Appeals for the Ninth Circuit, and that, in y opinion, the foregoing brief is in full compliance with hose rules.

Martin J. May

No. 22509

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FRANK J. EVANS and MARGUERITTE A. EVANS,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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I N D E X

CITATIONS

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ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court is reported at 48 T.C. 704.

JURISDICTION

This petition for review involves deficiencies in federal income taxes for the years 1962 and 1963 in the respective amounts of $41.21 and $1,089.35. (R. 90-91.) The taxpayer 1/ and his wife filed joint income tax returns with the District Director at San Francisco, California. (R. 67.) On March 11, 1966, the Commissioner mailed a

1/ For convenience, Frank J. Evans will be referred to in this brief as the taxpayer, although his wife, Margueritte A. Evans, is also a petitioner since she filed joint returns with her husband for the taxable years involved.

notice of deficiency showing deficiencies in income tax for the two years in the amounts of $236.43 for 1962 and $1,089.35 for 1963. (R. 5-10.) Within 90 days thereafter, and on June 2, 1966, the taxpayer and his wife filed a petition with the Tax Court for a redetermination of the deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 1-11.) The decision of the Tax Court, entered September 22, 1967, found that there were deficiencies in the amounts of $41.21 for 1962 and $1,089.35 for 1963. (R. 88-89.) The case is brought to this Court by a petition for review filed November 13, 1967 (R. 90-91), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Whether the taxpayer, an owner and operator of a trailer park, is entitled to an investment credit (under Sections 38, 46 and 48 of the Internal Revenue Code of 1954) for the cost of four utility connections (for water, electrical energy, natural gas, and sewage disposal) used by those who rented space in the trailer park.

STATUTES AND OTHER AUTHORITIES INVOLVED

The pertinent provisions of the statutes and other authorities involved are set out in the Appendix, infra.

STATEMENT

The facts as stipulated by the parties (R. 16-19), found by the Tax Court (R. 66-69), and supplemented by the record may be summarized as follows:

In 1962, the taxpayer purchased Opal Cliffs Mobile Homes Park, having space for 111 trailers, for $327,000, of which $143,000 was the cost of the land, and $184,000 the cost of improvements of which at least $12,500 was the cost of each of four utility systems for the distribution of electrical energy, natural gas, water, and for sewage disposal. (R. 16-17, 67.) During the taxable years 1962 and 1963, the four utility systems were used in connection with the taxpayer's operation of the trailer park as follows (R. 17-19, 67-68):

(a) The sewage disposal system required no special attention and the charge for its use to each mobile home owner was made as part of the monthly charge for space. The system in Opal Cliffs Mobile Homes Park is connected to the East Cliff Sanitation District and is under the control of Santa Cruz County, California. (R. 17, 67.)

(b) The water in Opal Cliffs Mobile Homes Park was supplied by the C. L. Beltz Water System, a public utility operating under authority from the California Public Utilities Commission, Decision No. 20189. Each mobile home owner in Opal Cliffs Mobile Homes Park is charged $2.00 per month by the taxpayer as part of the monthly charge for space, in accordance with the schedule of rates established by the California Public Utilities Commission in their Decision No. 49269, for the sale of water by the C. L. Beltz Water System. The taxpayer in turn pays the C. L. Beltz Water System at a monthly rate which averages $50.00 per month. (R. 17-18, 68.)

(c) The taxpayer purchases all of the electrical energy used in Opal Cliffs Mobile Homes Park from Pacific Gas & Electric Company and pays for it at a fixed rate. The taxpayer, in turn, supplies the electrical energy to the mobile home owners in Opal Cliffs Mobile Homes Park and bills each mobile home owner in accordance with the amount of electrical energy used during the previous month. The taxpayer reads the meters each month, maintains appropriate records, and bills the mobile home owners for the amount of electrical energy used each month in accordance with a schedule of rates approved by the California Public Utilities Commission. (R. 18, 68.)

(d) The taxpayer operates a natural gas distribution system in the same manner as the electrical energy distribution system except that the California Public Utilities document which governs is "revised Cal. P.U.C. Sheet No. 5898G". (R. 18-19, 68.) The four systems had useful lives of 20 years for computing depreciation. (R. 68.)

On their original return for 1962, the taxpayer and his wife did not claim any investment credit (R. 20-31, 69), but on March 26, 1964, they filed an amended return for 1962, claiming the four utility systems as assets qualifying as property entitled to investment credit 2/ (R. 51-61, 69). The taxpayer's computation of total investment credit was $3,696.70, of which $1,152.11 was used to offset the income tax for 1962. (R. 61, 69.) An application of the

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2/ Investment credit was also claimed for other items not here in issue. The amended 1962 return reduced reported net profit by $442 because of adjustments not here in issue. (R. 26, 56.)

credit resulted in a claimed overpayment for 1962 of $1,239.63. (R. 62, 69.) The difference between the total claimed investment credit and the amount claimed in 1962 was carried over and claimed by the taxpayer as a credit to the extent of the full amount of the tax for 1963, or $1,136.34 (R. 32-47.)

SUMMARY OF ARGUMENT

The taxpayer is not entitled to investment credits in 1962 and 1963, under Sections 38, 46, and 48 of the Internal Revenue Code of 1954, for the cost of utility connections for water, gas, electric energy, and sewage disposal used by the tenants of a trailer park owned and operated by the taxpayer. The Tax Court correctly held that the statute, applicable Treasury Regulations and legislative history of the investment credit provisions of the Code clearly show that the taxpayer is not entitled to the claimed investment credit.

Code Section 46 provides for a credit against tax equal to a percentage of the investment in "section 38 property" which is defined in Code Section 48 to mean either tangible depreciable personal property, or "other tangible property" used as an integral part of manufacturing, production, or extraction, or furnishing transportation, communications, electrical energy, gas, water, or sewage dispoal services. The Treasury Regulations have reasonably interpreted the definition of "other tangible property" to mean that it is an integral part of furnishing the enumerated services by a person engaged in a trade or business of furnishing any such service.

The purposes of the investment credit provisions were to encourage investments by respective industries in furtherance of that business's

capital expansion and to encourage modernization and expansion of the Nation's productive facilities and to improve its economic potential. The legislative history further indicates that Congress was granting tax incentives to a supplier rather than a consumer of public utility property.

Code Section 46(c)(3)(B) provides that investment credit for certain public utility property is available only to one using the property who is predominantly in the trade or business of furnishing or selling the utility services. Utility property qualifies as "section 38 property" only when a public utility, predominantly in the trade or business of furnishing utility services, invests in service property to furnish services to the Community.

The taxpayer's returns reported his occupation as trailer park owner or trailer park operator. Those who rented trailer space from him received the utilities in question as an incident to the rental. He was not a public utility; he was not predominantly or otherwise in the trade or business of furnishing utility services; and he did not "furnish" utilities to his renters. The utilities were furnished by the companies from which the taxpayer obtained the water, electric energy, natural gas, and sewage disposal service. The taxpayer was merely a conduit from the terminal point of the distribution systems. He was a consumer rather than a supplier. There is nothing in the record to show that he did more than keep records and pay and collect bills. His utility connections in the trailer park did not fall within the broad purposes of the investment credit provisions of the Code.

ARGUMENT

THE TAXPAYER IS NOT ENTITLED TO AN INVESTMENT CREDIT UNDER SECTIONS 38, 46 AND 48 OF THE INTERNAL REVENUE CODE OF 1954 FOR THE COST OF UTILITY CONNECTIONS FOR WATER, GAS, ELECTRICITY AND SEWAGE DISPOSAL USED BY THE TENANTS OF A TRAILER PARK OWNED AND OPERATED BY THE TAXPAYER

The sole question on this appeal is whether four utility connections for water, electricity, gas, and sewage disposal service, used by renters of trailer spaces in a trailer park owned and operated by the taxpayer, qualify as "section 38 property" so as to permit the taxpayer to take an investment credit for the cost of such connections in 1962 and 1963. The taxpayer contends (Br. 16-23) that these four connections are "section 38 property" as "other tangible property" 3/ under Section 48(a)(1)(B), of the Internal Revenue Code of 1954, Appendix, <u>infra</u>, and, therefore, that he is entitled to investment credit under Section 38 of the 1954 Code, Appendix, <u>infra</u>. It is submitted that the Tax Court correctly held (R. 65, 70-80) that the statute, Treasury Regulations, and legislative history clearly show that the taxpayer is not entitled to the claimed investment credit. See Rev. Rul 66-269, 1966-2 Cum. Bull. 13-14, Appendix, <u>infra</u>.

Code Section 38 provides for a credit against tax equal to a percentage of the investment in certain eligible property known as "section 38 property". "Section 38 property" is defined in Code Section 48 to mean either (a) tangible depreciable personal property, or (b) other tangible property (not including a building or its

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3/ No contention is made that the property in question qualifies as "Section 38 property" because it is "tangible personal property" under Code Section 48(a)(1)(A), Appendix, <u>infra</u>. It is clear from Section 1.48-1(c) of the Treasury Regulations on Income Tax under the 1954 Code, Appendix, infra, that electrical hookups, plumbing hookups, and oil and

structural components) if such property (i) is used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or (ii) constitutes a research or storage facility used in connection with these activities. Under Section 1.48-1(a) of Treasury Regulations on Income Tax (1954 Code), Appendix, <u>infra</u>, other tangible property may qualify as "section 38 property"--

> only if such other property is used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage dispoal services <u>by a person engaged in a trade or business of furnishing any such service</u>, or is a research or storage facility used in connection with any of the foregoing activities, * * * (Underlining supplied.)

The validity of this section of the Regulations was upheld by the Tax Court as reasonable and consistent with the intent of the statute (R. 72-73), and the taxpayer does not here contend otherwise.[4]

The purpose of the investment credit provision was to encourage investments by respective industries in furtherance of their capital expansion and "to encourage modernization and expansion of the Nation's productive facilities and to improve its economic potential * * *." See H. Conference Rep. No. 2508, 87th Cong., 2d Sess., p. 14 (1962-3 Cum. Bull. 1129, 1142); <u>Madison Newspapers, Inc.</u> v. <u>Commissioner</u>, 47 T.C. 630, 635. It is clear that the taxpayer's utility connections did not fall within the broad purpose of the investment credit provisions.

3/ (con't.) fall within the definition of "section 38 property" so as to qualify for investment credit as "tangible personal property." See also Rev. Rul. 66-269, 1966-2 Cum. Bull. 13, Appendix, <u>infra</u>.

4/ As the taxpayer's brief notes (p. 18), in the Tax Court he had unsuccessfully challenged the validity of the Regulations.

As the concurring opinion in the Tax Court pointed out (R. 78), the legislative history further indicates that Congress had in mind granting tax incentives for modernization and expansion to a supplier rather than to a consumer of public utility property. See, Detailed Explanation of the President's Recommendation Contained in his Message Taxation, 1 House Hearings before the Committee on Ways and Means on President's 1961 Tax Recommendations, 87th Cong., 1st Sess., pp. 256-257. Both the House and Senate Reports state, in language almost identical to the Regulations (H. Rep. No. 1447, 87th Cong., 2d Sess., p. A18 (1962-3 Cum. Bull. 405, 516) and S. Rep. No. 1881, 87th Cong., 2d Sess., p. 155 (1962-3 Cum. Bull. 707, 859)) that

> ***Property is to be considered as being used as an integral part of a system of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services <u>only if such property is used by one engaged in the trade or business of furnishing such services</u>. (Underlining supplied.)

An example is then given of a manufacturing firm which constructs an airstrip for use by airplanes operated for the convenience of its officers and employees, with the statement that such airstrip would not qualify as "section 38 property" since the manufacturing firm is not engaged in the transportation business. See H. Rep. No. 1447, <u>supra</u>, p. A18 (1962-3 Cum. Bull., p. 516), and S. Rep. No. 1881, <u>supra</u>, pp. 139, 155 (1962-3 Cum. Bull., pp. 843, 859).

Code Section 46(c)(3), Appendix, <u>infra</u>, provides that investment credit for certain public utility property is available only to one using the property who is "predominantly in the trade or business

of the furnishing or sale of electrical energy, water, or sewage disposal services." Section 1.46-3(g) of Treasury Regulations on Income Tax (1954 Code), Appendix, infra, after substantially repeating the words of the statute, states in part:

> ***If property is used by a taxpayer both in a public utility activity and in another activity, the characterization of such property shall be based on the predominant use of such property during the taxable year in which it is placed in service. (Underlining supplied.)

In other words, utility property qualifies as "section 38 property" only when a public utility, predominantly in the trade or business of furnishing utility service, invests in service property to furnish services to the community.

Section 1.48-1(h)(1)(ii) of Treasury Regulations on Income Tax (1954 Code), Appendix, infra, in excluding property used predominantly to furnish lodging or in connection with the furnishing of lodging from "section 38 property" eligible for the investment credit, states:

> ***Thus, such items as gas and electric meters, telephone poles and lines, telephone station and switchboard equipment, and water and gas mains, furnished by a public utility would not be considered as property used in connection with the furnishing of lodging. (Underlining supplied.)

Thus, in considering whether utility property qualifies for investment credit (notwithstanding the fact that it is a lodging facility or used in connection with the furnishing of lodging), the Regulations state it will qualify only where a public utility is using the property to furnish the services.

In this case, the taxpayer reported his occupation on his income tax returns (R. 20, 32, 51) either as "trailer park owner" or "trailer park operator." He rented space for trailers, and the renters of such space received the utilities in question as an incident to such rental. Contrary to the taxpayer's assertion (Br. 16-25), it is obvious that the taxpayer was not, predominantly or otherwise, in the trade or business of furnishing utility service, but made utilities available to his renters merely as an incidental part of his operation of the trailer park.

In fact, as the concurring opinion of the Tax Court points out (R. 78-80), the taxpayer was not "furnishing" the utilities to his renters at all. It was the C. L. Beltz Water System that furnished the water; the Pacific Gas & Electric Company furnished the electric energy and natural gas; and the East Cliff Sanitation District of Santa Cruz County furnished the sewage disposal system. The taxpayer merely acted as a conduit for them, obtaining as a consumer the water, electric energy, gas, and sewage disposal services from these suppliers, and then merely transmitting them to his renters of trailer space. The taxpayer was actually a consumer rather than a supplier, and merely acted as a conduit for the services from the terminal point of the distribution systems. The stipulated facts show (R. 17-19) merely that he read meters, maintained appropriate records, and billed the trailer owners for the various utilities they used. There is nothing to show that he did more than keep records and pay and collect bills.

The taxpayer, thus, was not a public utility, was not predominantly or otherwise in the trade or business of furnishing utility services, and, in fact, did not furnish the utilities in question at all. If the taxpayer's position were followed, every apartment owner who includes in the rent charged his tenants such items as water, electricity, gas, and sewage disposal, would be entitled to investment credit for the water lines, electrical, gas, and plumbing connections. The Commissioner's position is supported by Rev. Rul. 66-269, 1966-2 Cum. Bull. 13-14, where a taxpayer requested a ruling as to whether electrical hookups, and utilities used at a trailer park qualified for investment credit. In determining that they did not so qualify, the Commissioner pointed out (1) that such property was similar to oil and gas pipe lines which are considered real property[5/] (See H. Rep. No. 1447, supra, p. 12 (1962-3 Cum. Bull., p. 416): and (2) that the property failed to qualify as "other tangible property" used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, by a person engaged in a trade or business of furnishing any such service (see Code Section 48(a)(1)(B)(i) and Section 1.48-1(d) of Treasury Regulations on Income Tax (1954 Code), Appendix, infra.

5/ In the Tax Court, the taxpayer argued that the gas and electric meters were tangible personal property, but since the record contains no evidence of their cost as a separate item, nor any basis for an allocation, the Tax Court found it unnecessary to discuss the contention. The taxpayer has not raised the point on appeal.

It was unnecessary for the Tax Court to resort to Section 1.355-1(c) of the Treasury Regulations on Income Tax (1954 Code), as the taxpayer contends (Br. 18-21), and it did not do so. Code Sections 38, 46 and 48, the applicable Treasury Regulations, and the legislative history of the investment credit provisions, clearly show that the Tax Court properly denied the claimed investment credit in 1962 and 1963 for the cost of utility connections by which the renters of trailer space incidentally received water, gas, electricity, and sewage disposal services in the taxpayer's trailer park.

CONCLUSION

The Tax Court's decision was correct and should be affirmed.

Respectfully submitted,

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June, 1968.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated:____________________ day of ________________ 1968.

____
Carolyn R. Just

APPENDIX

Internal Revenue Code of 1954:

SEC. 38 [as added by Sec. 2(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY.

(a) General Rule.--There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations.--The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

(26 U.S.C. 1964 ed., Sec. 38.)

SEC. 46 [as added by Sec. 2(b), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. AMOUNT OF CREDIT.

*　　　　*　　　　*

(c) Qualified Investment.--

*　　　　*　　　　*

(3) Public utility property.--

(A) In the case of section 38 property which is public utility property, the amount of the qualified investment shall be 3/7 of the amount determined under paragraph (1).

(B) For purposes of subparagraph (A), the term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of--

(i) electrical energy, water, or sewage disposal services,

(ii) gas through a local distribution system,

(iii) telephone service, or

(iv) telegraph service by means of domestic telegraph operations (as defined in section 222 (a)(5) of the Communications Act of 1934, as amended; 47 U.S.C., sec. 222(a)(5),

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

* * *

(26 U.S.C. 1964 ed., Sec. 46.)

SEC. 48 [as added by Sec. 2(b), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. DEFINITIONS; SPECIAL RULES.

(a) Section 38 property.--

(1) In general.--Except as provided in this subsection, the term "section 38 property" means--

(A) tangible personal property, or

(B) other tangible property (not including a building and its structural components) but only if such property--

(i) is used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research or storage facility used in connection with any of the activities referred to in clause (i)

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 4 years or more.

* * *

(26 U.S.C. 1964 ed., Sec. 48.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.46-3 Qualified investment.

*   *   *

(g) Public utility property. (1) In the case of section 38 property which is public utility property, the amount of the qualified investment with respect to such property shall be 3/7 of the amount otherwise determined under this section with respect to such property.

(2) The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of--

(i) Electrical energy, water, or sewage disposal services,

(ii) Gas through a local distribution system,

(iii) Telephone service, or

(iv) Telegraph service by means of domestic telegraph operations (as defined in section 222(a)(5) of the Communications Act of 1934, as amended; 47 U.S.C., sec. 222(a)(5)),

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State (including the District of Columbia) or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof. The term "established or approved" includes the filing of a schedule of rates with any body named in the preceding sentence which has the power to approve such rates, even though such body has taken no action on the filed schedule. For purposes of this paragraph, any activity described in subdivision (i), (ii), (iii), or (iv) of this subparagraph, which is regulated in a manner described in this subparagraph, shall be referred to as a "public utility activity". If property is used by a taxpayer both in a public utility activity and in another activity, the characterization of such property shall be based on the predominant use of such property during the taxable year in which it is placed in service.

*   *   *

(26 C.F.R., Sec. 1.46-3.)

§ 1.48-1 Definition of section 38 property.

(a) In general. Property which qualifies for the credit allowed by section 38 is known as "section 38 property". Except as otherwise provided in this section, the term "section 38 property" means property (1) with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the taxpayer, (2) which has an estimated useful life of 4 years or more (determined as of the time such property is placed in service), and (3) which is either (i) tangible personal property, (ii) other tangible property (not including a building and its structural components) but only if such other property is used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such service, or is a research or storage facility used in connection with any of the foregoing activities, * * *

*   *   *

(d) Other tangible property--(1) In general. In addition to tangible personal property, any other tangible property (but not including a building and its structural components) used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such service, or which constitutes a research or storage facility used in connection with any of the foregoing activities, may qualify as section 38 property.

*   *   *

(3) Transportation and communications businesses. Examples of transportation businesses include railroads, airlines, bus companies, shipping or trucking companies, and oil pipeline companies. Examples of communications businesses include telephone or telegraph companies and radio or television broadcasting companies.

(4) Integral part. In order to qualify for the credit, property (other than tangible personal property and research or storage facilities used in connection with any of the activities specified in subparagraph (1) of this paragraph)

must be used as an integral part of one or more of the activities specified in subparagraph (1) of this paragraph. Property such as pavements, parking areas, inherently permanent advertising displays or inherently permanent outdoor lighting facilities, or swimming pools, although used in the operation of a business, ordinarily is not used as an integral part of any of such specified activities. Property is used as an integral part of one of the specified activities if it is used directly in the activity and is essential to the completeness of the activity. Thus, for example, in determining whether property is used as an integral part of manufacturing, all properties used by the taxpayer in acquiring or transporting raw materials or supplies to the point where the actual processing commences (such as docks, railroad tracks and bridges), or in processing raw materials into the taxpayer's final product, would be considered as property used as an integral part of manufacturing. Specific examples of property which normally would be used as an integral part of one of the specified activities are blast furnaces, oil and gas pipelines, railroad tracks and signals, telephone poles, broadcasting towers, oil derricks, and fences used to confine livestock. Property shall be considered used as an integral part of one of the specified activities if so used either by the owner of the property or by the lessee of the property.

* * *

(h) Property used for lodging--(1). In general. (i) Except as provided in subparagraph (2) of this paragraph, the term "section 38 property" does not include property which is used predominantly to furnish lodging or is used predominantly in connection with the furnishing of lodging during the taxable year. * * * The term "lodging facility" includes an apartment house, hotel, motel, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let, * * *

(ii) Property which is used predominantly in the operation of a lodging facility or in serving tenants shall be considered used in connection with the furnishing of lodging, whether furnished by the owner of the lodging facility or another person. Thus, for example, lobby furniture, office equipment, and laundry and swimming pool facilities used in the operation of an apartment house or in serving tenants would be considered used predominantly in connection with the furnishing of lodging. However, property which is used in furnishing, to the management of a lodging facility or its tenants, electrical energy, water,

sewage disposal services, gas, telephone service, or other similar services shall not be treated as property used in connection with the furnishing of lodging. Thus, such items as gas and electric meters, telephone poles and lines, telephone station and switchboard equipment, and water and gas mains, furnished by a public utility would not be considered as property used in connection with the furnishing of lodging.

*　　　　*　　　　*

(26 C.F.R., Sec. 1.48-1.)

Rev. Rul. 66-269, 1966-2 Cum. Bull. 13:

Advice has been requested whether certain assets used at a trailer park qualify for the investment credit. Specifically, the property in question includes electrical hookups, plumbing hookups, and water wells.

Included in the costs of plumbing hookups are the surveyor fees, the digging of trenches, the installation of water and sewer pipes, the construction of a mound of rocks as a drainage field, septic tanks for dumping on the drainage field. The electrical hookups include the costs of lead-in wires from the utility poles, which were installed throughout the trailer park, the costs of hookup boards, fuse boxes, and plug-in units. The cost of water wells include the actual drilling, the well casings, and electric pumps.

Section 48 of the Internal Revenue Code of 1954 provides, in part, that for property to qualify as "section 38 property" for which an investment credit is allowed, it must be either (1) tangible personal property or (2) other tangible property (not including a building or its structural components) used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services.

"Tangible personal property" is defined in section 1.48-1(c) of the Income Tax Regulations to include all tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). In addition, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure), shall be considered tangible personal property even though located outside a building. Thus,

for example, a gasoline pump, hydraulic car lift, or automatic vending machine, although annexed to the ground, shall be considered tangible personal property. Furthermore, H.R. Report No. 1447, Eighty-seventh Congress, second session, C.B. 1962-3, 405, at 415, states that tangible personal property is not intended to be defined narrowly, nor necessarily to follow the rules of State law. Although assets accessory to a business such as grocery store counters, printing presses, etc., are to qualify for the credit, the same Committee Report, at page 416, specifically considers property such as oil and gas pipelines and fences to be real property.

The electrical hookups, plumbing hookups, and water wells are in the nature of land improvements, similar to oil and gas pipelines which are considered as real estate. Only the electric pumps used in connection with these facilities qualify as tangible personal property.

"Other tangible property," as defined in section 1.48-1(d) of the regulations, is property used as an integral part of manufacturing, production or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such service. The properties in question do not qualify under this definition.

Accordingly, electrical hookups, plumbing hookups, and water wells, except for the electric pumps used in connection therewith, installed at a trailer park are not "section 38 property."

NO. 22509

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

- - -

ANK J. EVANS and	)
	)
RGUERITTE A. EVANS,	)
	)
Appellants,	)
	)
v.	)
	)
MISSIONER OF INTERNAL REVENUE,	)
	)
Appellee.	)
	)

APPELLANT'S REPLY BRIEF

peal from the Decision of the Tax Court of the United States, norable Norman O. Tietjens, Judge. (Decision Reviewed by the urt).

NOLAND, HAMERLY, ETIENNE & FULTON

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Counsel for Appellants

INDEX

CITATIONS

ARGUMENT

lity Connections

The appellee in the heading and several places in the body of argument refers to "utility connections". Although it is a nparatively minor point, it should be made clear that the stipu-ted facts in the case contain no reference to "utility connections" that term is not defined in appellee's brief or elsewhere. The pulation of facts (R.17, 18, 19) clearly states in several ces (e.g., Stip. No. 3, R.16, 17) that the appellant purchased operated four utility systems which, it is stipulated, had a nbined total cost of not less than $50,000. Apparently appellee using the term "utility connections" hopes to create the impres-on that the utility systems in issue are comparatively minor in ure. However, the utility systems are extensive, covering 111 bile home spaces, and complete, including for example gas and ctric meters for each mobile home.

mittee Report Citation

The appellee in his brief on page 8 states as follows:

> "The purpose of the investment credit provision was to encourage investment by respective industries in furtherance of their capital expansion and "to encourage modernization and expansion of the Nation's productive facilities and to improve its economi potential***". See H. Conference Report No. 2508 87th Cong. 2nd Session Page 14 (1962-3 C.B. 1129, 1142); Madison Newspapers Inc. v. Commissioner 47 TC 630, 635. It is clear that the taxpayer's utility connections did not fall within the broad purpose of the investment credit provisions".

The citation to the conference committee report is to the

atement of the managers on the part of the House, and it reads in

ll as follows:

> "It is the understanding of the conferees on the part of both the House and the Senate that the purpose of the credit for investment in certain depreciable property, in the case of both regulated and non-regulated industries, is to encourage modernization and expansion of the Nation's productive facilities and to improve its economic potential by reducing the net cost of acquiring new equipment, thereby increasing the earnings of the new facilities over their productive lives." (Underscoring supplied).

After the statement with respect to the conference report and

e Madison Newspapers case is placed in its full context, it is

ear that the four systems in issue here come within the investment

edit provisions, especially if the underlined portion of the full

xt of the committee report above is emphasized. It must, of course,

borne in mind that used as well as new equipment and facilities

alify for the investment credit.

The reference to the conference committee report and to

dison Newspapers, Inc. v. Commissioner, Supra, were taken almost

rbatim from the concurring opinion (R.79), and it is noteworthy

at after the material quoted above the concurring opinion continues

follows:

> "Perhaps, if petitioners had operated their own power station, or purchased and stored bottled gas in quantity, and maintained systems of distributing electricity of gas therefrom to their trailer park tenants, they would be entitled to the benefit of the investment credit -- whether or not they operated such systems separately or at a profit.***"

This portion of the concurring opinion is commented upon in

pellant's brief, third paragraph on page 22. As pointed out there,

Judge Tannewald had been aware of the minute difference between chasing bottled gas and distributing it to mobile home owners the one hand, and purchasing electrical energy, gas and water, distributing those to the mobile home owners on the other hand, difference being only that in one instance there was an entory, whereas in the other instance, there was no inventory, is quite likely that he (Judge Tannewald) would have changed opinion on the entire matter.

In any event, the quotation from the committee report and the ation of Madison Newspapers, Inc., is of little value in attempt- to arrive at a solution to the problem before the court.

sumer

In the first paragraph at the top of page 9 of appellee's ef, appellant is characterized as being the "consumer" of the services which were supplied to the mobile home owners in l Cliffs Mobile Homes Park. This characterization of the ellant as the consumer of the electrical energy, gas, water and age disposal services again arises from the concurring opinion Judge Tannewald, and is contrary to the stipulated facts in the e because if appellant was the consumer, then there would be two sumers of the same services. That is, appellant would be the sumer and the owners of the mobile homes in Opal Cliffs Mobile es Park would also be the consumers. This, it is submitted, is ently impossible. Perhaps it would be well to refer to the tionary for a definition of the word "consumer". The following inition is from Webster's New International Dictionary of the lish Language (1931) pg. 483:

"Consumer - 1. One that consumes. 2. Economics - one who uses (economic) goods, and so diminishes or destroys their utilities; - opposed to producer".

Going one step further, the word "consume" is defined in the

e dictionary as follows at page 483:

"Consume - 1. To destroy, as by decomposition, dissipacion, waste or fire. 2. To use up, expend, waste; devour. Consume - v.i. to waste away or suffer destructions".

It is clear from the stipulated facts that the appellant did

use up, expend,waste, or devour the electrical energy, gas,

er and sewage disposal services which were used by the mobile

e owners in Opal Cliffs Mobile Homes Park; therefore, by

inition, appellant was not the "consumer" of the electrical

rgy, gas, water, and sewage disposal services in this case.

field example

On page 9 of appellee's brief, the following quote appears:

"An example is then given of a manufacturing firm which constructs an airstrip for use by airplanes operated for the convenience of its officers and employees, with the statement that such airstrip would not qualify as "Section 38" property since the manufacturing firm is not engaged in the transportation business***".

This example is readily distinguished from the present fact

uation. In the example, the airstrip was simply a matter of

venience for the officers and employees of the manufacturing

poration, and therefore was not essential to the functioning of

manufacturing business; however, in the instant case, the four

stems in issue are essential to the operation of Opal Cliffs

bile Homes Park which is a separate entity, economically and

graphically, and the appellant is engaged in a trade of

siness of furnishing electrical energy, gas, water, and sewage

sposal services for the separate economic and geographic entity

is indicated by the stipulation of facts (R.17, 18, and 19).

blic Utility Property

In the paragraph at the bottom of page 9 of appellee's brief ich continues over to page 10, appellee goes into the rules for termining what property is public utility property for a siness which is engaged both in a public utility activity and activity which is not a public utility activity. It is note-rthy that appellee has skipped a link in his analysis, in that fails to show or even allege that the property in issue in the stant case is public utility property. Since appellee has ver contended that appellant was engaged in a public activity, he premature in applying section 46(c)(3) and section 1.46-3(g) Treasury Regulations on Income Tax (1954 Code).

The appellee apparently is contending that the property in sue can only qualify for the investment credit if it is first termined that the property is public utility property. There is requirement in the code, regulations or elsewhere that "other ngible property" under section 48(a)(1)(B) of the Internal venue Code of 1954 must qualify as public utility property before will qualify as "Section 38 property".

It is submitted that the correct sequence of analysis is first determine whether the property in question qualifies under ction 48(a)(1)(B) of the Internal Revenue Code of 1954, and if is determined that the property qualifies under section 48(a)(1)(I e property is then classified as Section 38 property. The next ep is to determine whether the property is public utility operty by applying section 46(c)(3). The sole function of section

(c)(3) is to limit the investment credit on public utility property to 3/7th of the amount otherwise allowable. As noted above, the issue of whether the property in question is public utility property has never been raised by appellee; therefore, appellee in discussing section 46(c)(3) on pages 9 and 10 of his brief is applying an erroneous standard.

rnishing lodging

In the last full paragraph on page 10 of his brief, appellee takes up the question of the applicability of section 1.48-1(h)(1)(i) of Treasury Regulations on Income Tax (1954 Code). This section of the regulations applies only where a taxpayer is engaged in the trade or business of furnishing lodging. The appellee has made no allegation that appellant is in the trade or business of furnishing lodging, also, the Tax Court on stipulation of counsel for appellee, allowed the appellant an investment credit for the cost of washing machines and dryers purchased by appellant in 1962 (R.19,66).

If the appellee believed that the appellant was engaged in the operation of a lodging facility, he would not have stipulated that the appellant was entitled to the investment credit on the washing machines and dryers because of the limitation on section 38 property in section 48 (a)(3) which is amplified in Regulation section 1.48-1(a)(h)(ii) as follows:

"The property which is used predominantly in the operation of a lodging facility or in serving tenants shall be considered used in connection with the furnishing of lodging, whether furnished by the owner of the lodging facility or another person. Thus, for example, lobby furniture, office equipment and laundry and swimming pool facilities used in the operation of an apartment house or in serving tenants would be considered used predominantly in connection with the furnishing of lodging."

It is thus apparent from the previous actions of the appellee [i]n this case that he considers the appellant to be in a business [ot]her than that of furnishing lodging. This of course means that [th]e reasoning of the appellee in the last full paragraph on page 10 [of] his brief is erroneous and inconsistent with the previous actions [ta]ken in the case.

Also, the Internal Revenue Service in Revenue Ruling 66-269, [19]66-2 Cum.Bull. 13 sets forth its (Internal Revenue Service's) [po]sition with respect to trailer parks and the investment credit [an]d therein does not mention the subject of the lodging business [li]mitation while approving an investment credit for electric pumps [us]ed by the owner of a trailer park.

[Oc]cupation

In the first paragraph on the top of page 11 of his brief, the [ap]pellee indicates that the appellant stated his occupation to be ["t]railer park owner" or "trailer park operator". This is true, [ho]wever, by looking at the exhibits reproduced in the record (R.20 [...], 51) it will be noted that the space is rather small and has [in]sufficient room for entering more than one occupation. Therefore, [th]ere is little probative value to this particular entry in the [ap]pellant's income tax returns.

rnishing

In the second full paragraph on page 11 of his brief, pellee again quotes the concurring opinion of Judge Tannewald the effect that the appellant was not "furnishing" the utilities the owners of mobile homes in Opal Cliffs Mobile Homes Park. so, in this section of his brief, appellee again argues that the pellant is the "consumer" of the services in question.

The question of the proper use and definition of the word onsumer" as applied in this case was taken up in an earlier part this reply brief, therefore it is unnecessary to go over that int again. The word "furnishing" is an important word in the atute and it should be examined in order to determine what s intended by Congress when it used the word. In Webster's New ternational Dictionary of the English Language (1931), the llowing definition of "furnishing" is given at page 879:

> "Furnishing - 1. Act of supplying furniture or fittings. 2. Ornament; adornment. 3. pl. Furniture, fixtures, apparatus, etc."

That definition is of little help however, the word furnish is fined in the same dictionary as follows at page 879:

> "Furnish - 1. To accomplish; insure. obs. 2. To provide for, to provide what is necessary for; to fulfill or satisfy the needs of; to equip; to fit out or fit up; as to furnish an expedition; to furnish a table; to furnish a man for a journey; of things, to serve as furnishing or provisions for; - often with forth or out. 3. Specif. To supply with furniture and fittings, as to furnish a house. 4. To provide; supply; give; afford; specif.: a. To supply (a person, thing with something); as to furnish the garrison with troops; - formerly also with of. b. To supply or offer(something); to give; present; yield; as to furnish food to the hungry; to furnish sound reasons."

In applying the definition above to the instant case, it ould be borne in mind that the stipulated facts show appellant rchased electrical energy, gas and water, distributed the elec-ical energy, gas and water through his distribution system to the ners of mobile homes in Opal Cliffs Mobile Homes Park, charged, lled and collected for the electrical energy, gas and water at a ice in excess of the purchase price, and maintained the entire stem within the geographic boundary of Opal Cliffs Mobile Homes rk. Also, it is noteworthy that the following language appears Exhibit 4-D to the stipulation of facts (R.49).

"(C.) Resale of electricity
A customer shall not <u>furnish</u> or <u>resell</u> electricity received from the utility <u>to any person except</u>:***." (Underscoring supplied).

Almost the exact language appears in Exhibit 5-E (R.50) governg the resale of gas.

The foregoing definition and facts indicate that appellant urnished" electrical energy and gas by resale to the mobile home ners in Opal Cliffs Mobile HOmes Park. Similar conclusions would appropriate for the water and sewer systems. It is quite possible at Judge Tannewald overlooked the contents of Exhibits 4-D and 5-E concluding that appellant was not "furnishing" electrical energy, s, water, and sewage disposal services to the owners of mobile mes in Opal Cliffs Mobile Homes Park.

Appellee apparently would confine the use of the word "furnish" "furnishing" to a manufacturer engaged in retailing his product. e definitions are devoid of any language which would support this terpretation. Likewise, the actual use of the word furnish in hibits 4-D and 5-E (R.49,50) is contrary to such a limited meaning.

venue Ruling 66-269

On page 12 of his brief, appellee refers to Revenue Ruling -269, 1966-2 CUM Bull. 13, which first appeared in Internal venue Bulletin 1966-39, September 26, 1966. The petition in the stant case was filed in the Tax Court on June 3, 1966 (Tax Court cket page 1) some three and one-half months prior to the time at Revenue Ruling 66-269 was published. It is not the intent of e comparison of dates to suggest that Revenue Ruling 66-269 was sued because the instant case was at issue in the Tax Court; wever, it would seem strange if one of the litigants in a contested tter could prevail by publishing a document setting forth his inion of the law after the case was before a court, and then te that opinion as authority to the court in the litigated case. e point that should be kept clearly in mind is that the Revenue ling represents an interpretation by the Internal Revenue Service out the application of Section 48(a)(1)(B) and that the Internal venue Service is a party to this action. Therefore, it would not pear to be proper for the Court to decide the case in reliance upon venue Ruling 66-269.

Aside from the self-serving nature of Revenue Ruling 66-269, is distinguishable from the facts in the instant case. The venue Ruling does not cover a situation where the trailer park owne s purchasing the electrical energy, gas and water at one price and selling them to the owners of trailer homes at an increased price. nce the aforementioned facts are not present in Revenue Ruling -269, its value as a precedent is severely limited. Another point

bout the Ruling is that it seems to be in conflict with the oncurring opinion of Judge Tannewald in this case, in that pparently Judge Tannewald would permit the investment credit for e water well and the water system because the entire water stem in the trailer park would have been operated by the owner the park, that is, the owner of the park would be "furnishing" ter to the trailer home owners. This result, according to dge Tannewald, would not be altered by the fact that the water stem might not have been operated separately or at a profit.

It is interesting to note that Revenue Ruling 66-269 alyzes the question of whether the trailer park owner was titled to the investment credit by using the rules in Section of the Internal Revenue Code of 1954 and not by using the les in Section 46(c)(3) of the Internal Revenue Code of 1954 appellee is attempting to do on pages 9 and 10 of his brief.

SUMMARY

Appellee is attempting to apply an incorrect standard in
ting section 46(c)(3) as the governing section for the
termination of whether the utility systems in issue qualify
"section 38 property". The correct standard as set forth in
pellant's opening brief is section 48 (a)(1)(B). The
pellant was engaged in furnishing electrical energy, gas,
ter and sewage disposal services to the consumers of those
rvices (the mobile home owners in Opal Cliffs Mobile Home
rk); therefore, the property used in furnishing those services
"section 38 property" under the standards of section 48(a)
)(B).

CONCLUSION

The decision of the Tax Court should be reversed.

Respectfully submitted,

NOLAND, HAMERLY, ETIENNE & FULTON

By ______________________

Martin J. May

I certify that, in connection with the preparation of this reply brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Martin J. May

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAMES RILEY, JR., and
FRANK MARSHALL,
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

No. 22,511

On Appeal from the Judgment of
The United States District Court
For the District of Arizona

BRIEF FOR APPELLEE

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SUBJECT INDEX

CASE INDEX

STATUTE

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAMES RILEY, JR., and FRANK MARSHALL, *Appellants,* vs. UNITED STATES OF AMERICA, *Appellee.*	No. 22,511

On Appeal from the Judgment of

The United States District Court

For the District of Arizona

BRIEF FOR APPELLEE

I.

JURISDICTIONAL STATEMENT OF FACTS

The Government accepts and adopts the Appellants' Jurisdictional Statement of Facts with the following additions. Both Appellants received a sentence of ten years on each count, said

sentences to run concurrently. The Trial Court set bail on appeal at $25,000.00 for each Appellant. Both Appellants are in custody. At trial, the Appellants' counsel was retained by both Appellants, and on appeal trial counsel was appointed under the Federal Criminal Justice Act (18 U.S.C.A., §3006A) to represent Appellant Frank Marshall. He is still retained counsel for Appellant James Riley, Jr.

(Hereinafter the Transcript of the Record, Volume I will be referred to as "RC"; the Reporter's Transcript of the testimony at trial will be referred to as "RT," the Reporter's Transcript of the testimony at the hearing of the Motion to Suppress will be referred to as "M RT"; the number following "RT" or "M RT" will refer to the page, and the number following "L" will refer to the line of the page. Appellant James Riley, Jr., will be referred to as "Defendant Riley" or "Riley" and Appellant Frank Marshall will be referred to as "Defendant Marshall" or "Marshall.")

II.

STATEMENT OF FACTS

In the early hours of the morning of May 17, 1967, Customs Agent John H. Dennis received a telephone call from a Nogales, Arizona, police sergeant reporting his suspicions regarding three persons occupying an automobile parked on Grand Avenue, Nogales, Arizona (RT 100-102). Dennis promptly went to the scene and located the vehicle (RT 132). While he had the vehicle under observation, it was moved to several different locations in Nogales, Arizona; the occupants left the vehicle on a number of occasions, sometimes only one occupant leaving and sometimes two leaving (RT 132-133). Dennis observed one occupant make several telephone calls from a booth in the Safeway Store parking lot, about 100 yards from the main gate into Mexico; and he observed the same

person making telephone calls from other booths located about the City of Nogales, Arizona (M RT 16). The three occupants of the vehicle were Negro males, Clifford Gray, Billy Joe Campbell, and Kelvin D. Reed (RT 132). During the course of his surveillance, Dennis telephoned Customs Agent Horace Cavitt for assistance and, upon arrival, Cavitt noted some of the movements of the vehicle and the actions of its occupants (RT 131).

About 4:00 p.m. on May 18, 1967, Dennis observed the same automobile parked again on Grand Avenue in approximately the same location at which it was in the early morning of May 17 (RT 133). At that time, the occupants of the vehicle were Kelvin D. Reed and two other colored persons, defendant James Riley, Jr., and a woman, Janet Johnnie Stanley (RT 134). While Agent Dennis, with Customs Agent Washington and Customs Port Investigator Turner, had the automobile under observation from about 4:00 p.m. to midnight, Dennis observed the occupants sitting in the car for hours at a time, with one or more of them leaving and returning to the car on occasion (RT 135). At one time, when a police officer came close to the car, defendant Riley and Miss Stanley left the car, entered a bus station, watched the police officer through a window for a short time, and then returned to the car (RT 135). About 8:00 p.m., Dennis observed dedefendent Riley and Miss Stanley leave the car and walk into Mexico through the Grand Avenue entrance gate. While Riley and Miss Stanley were in Mexico, Dennis observed that Reed left and reentered the car numerous times, walking up and down Grand Avenue (RT 135). About midnight, Dennis saw defendant Riley and Miss Stanley reenter the United States from Mexico and walk, by a circuitous route, to where the automobile was parked, meeting Reed at the automobile (RT 135). Dennis observed that after the three talked in the car, Reed

left the car, walked to the corner, and entered a taxicab, getting into the front seat beside the driver (RT 136). When Reed entered the taxicab, a Mexican male was in the rear seat; and after about five minutes elapsed, the taxicab drove to its stand near the Grand Avenue entrance to Mexico, where Reed left the cab (RT 136). Then, Dennis observed Reed return to the automobile in which he had left defendant Riley and Miss Stanley, reenter the car, and remain there briefly (RT 137). Dennis then saw Reed leave the automobile and walk north on Grand Avenue about one and one-half blocks to the northwest corner of Arroyo and Crawford Streets (RT 137). About the same time, Dennis observed defendent Riley and Miss Stanley in the automobile, Miss Stanley driving, circle the block twice and pick up Reed at the corner of Arroyo and Crawford Streets the second time around the block (RT 137). Dennis then observed the automobile depart Nogales and go north on Highway 89 toward Tucson (RT 137-138). Dennis and Customs Port Inspector Turner followed the automobile for a distance but, having the belief that the occupants had not picked up any contraband, they discontinued the surveillance (RT 138).

About May 21, 1967, Agent Cavitt received information from a reliable informant that two colored males, associates of Billy Joe Campbell, who is known to Cavitt as a narcotics trafficker, were negotiating with a Mexican, Pancho Martinez, at Nogales, Sonora, to buy a large amount of heroin from Martinez (M RT 36-37). The reliability of the informant is attested by the fact that seizures of narcotics and arrests had resulted in about 20 of 25 occasions in the past when the informer furnished information to Agent Cavitt (M RT 37). A few days later, the informant told Cavitt that the colored males had taken six ounces of heroin from Nogales, Sonora, to Chicago, Illinois, and that they would return to Nogales,

Arizona, on Monday, June 5; that Pancho Martinez was going to Culiacan to pick up some narcotics and would bring them back to Nogales, Sonora, and meet the colored males with it about June 5 (M RT 38). Shortly after receiving this information, Agent Cavitt passed on to Agent Dennis the part about two colored males having taken six ounces of heroin from Nogales to Chicago; and on May 27, Cavitt repeated that information to Dennis and also told Dennis of the word he had obtained that Pancho Martinez had gone to Culiacan to obtain narcotics which two colored males desired to purchase, and that the colored men would be back in Nogales, Arizona, on June 5, 1967 (M RT 22).

On Monday, June 5, 1967, Customs Agent Holgerson, whom Dennis had asked to be alert for the presence in Nogales of two colored males whom Dennis described, informed Dennis that he believed he had seen these men making a phone call from a booth in front of the Mission Motel on Grand Avenue in Nogales, Arizona (M RT 22-23). Dennis, with Agent Cavitt, promptly went to the Mission Motel and, describing two colored males to the manager, asked if they were registered there (M RT 23). The manager stated he had a party of three Negroes registered and exhibited the registration cards of Mr. and Mrs. James Riley, Jr., and another card on which the registrant's name was illegible (RT 138). Thereafter, Dennis learned that the rooms assigned to the registrants were occupied by defendants Riley and Marshall and Miss Stanley (RT 138).

During the morning of June 5, Dennis observed defendants Riley and Marshall, with Miss Stanley, in a yellow Ford Mustang bearing Arizona plates and, by checking, Dennis learned that the automobile was a rental car (RT 139). About noon of June 5, Dennis observed defendants and Miss Stanley in a second rental car, a blue Ford Fairlane, pulling into the Mis-

sion Motel (RT 139). He observed that they stopped at the Mission Motel only briefly, picked up a bag, and then proceeded north out of Nogales on Highway 89 (RT 139). Dennis, accompanied by Agents Cavitt and Washington, and Customs Agent-in-Charge Cameron, followed in automobiles and, although no report had been received by Cavitt from his informant that defendants had actually purchased narcotics from Pancho Martinez, the agents stopped the vehicle occupied by defendants and Miss Stanley at a point about 90 miles from Nogales, Arizona (M RT 24-25; RT 140). The agents took the vehicle and its occupants to the Sheriff's Office at Marana, Arizona, a short distance from where the agents stopped the vehicle, and there searched the defendants and the vehicle (RT 140). The search disclosed no contraband but did disclose that the defendant Riley was carrying on his person approximately $5,000 in cash (RT 248).

On June 6, 1967, Agent Dennis, while attending the United States District Court in Tucson, received a message from the Customs Agency secretary at Nogales, Arizona, that the manager of the Mission Motel had advised her that the defendants had returned to Nogales and had registered at the motel at approximately 1:00 a.m. that day (M RT 25-26; RT 33). In the early evening of June 6, Agent Dennis observed the defendants, carrying some curios, come to the Mission Motel in a taxicab bearing Mexican license plates (RT 142-143). He observed defendants enter their motel rooms and soon return to join Miss Stanley on the motel veranda (RT 142-143). Soon thereafter, Dennis saw the defendants begin making telephone calls from the booth outside the motel, making in all about ten calls (RT 143). At approximately 10:00 p.m., a taxicab bearing Arizona plates came to the motel and the defendants and Miss Stanley entered it, carrying one bag (RT 144). Dennis then observed defendants put Miss

Stanley on a northbound bus which departed Nogales, Arizona (RT 194). Thereafter, Dennis observed the defendants return in the taxicab to the Mission Motel, where the cab stopped momentarily, and then, without either defendant having left the cab, it returned to the bus station (RT 144). Dennis then saw the defendants alight from the taxicab and walk into Mexico (RT 144).

On June 6 or 7, after the search of the defendants at Marana, Agent Cavitt's informant advised him that Pancho Martinez had not as yet returned to Nogales from his trip to Culiacan for narcotics but that the informant would watch Martinez's house for his return and would notify Cavitt immediately upon his return (M RT 39). On June 7, the same informant telephoned the Customs Agency Office at Nogales, Arizona, and, when Agent Cavitt was unavailable, informed Agent Washington that "two colored guys," describing them so that Washington readily identified them as the defendants, were in Nogales, Sonora, waiting for the return of Pancho Martinez (M RT 81). Washington promptly informed Cavitt of the call and what the informer had told him (M RT 81). About 6:00 p.m. on the same day, the informant telephoned Cavitt and told him that Martinez had returned to Nogales, Sonora, and had "sold those guys that stuff" and that Martinez had 50,000 pesos ($4,000) (M RT 81-82). Because of his talk with Agent Washington earlier that same day, when the informant described the sale from Martinez to "those guys," Cavitt knew the informant had reference to the defendants (M RT 81-82). Immediately after receiving the telephone call, Cavitt communicated with Agent Washington by radio and gave him the information he had received from the informant regarding the sale by Martinez to the defendants (M RT 81-82).

On June 7, 1967, about 6:00 p.m., while Agent Dennis was in his automobile on the Tucson-Nogales Highway, at a

point about 35 miles north of Nogales, he observed defendants in a Nogales, Arizona, taxicab being driven in a northerly direction towards Tucson (RT 145). Dennis, of course, had in mind the fact that he had been informed earlier that defendants would return to Nogales about June 5 to deal with Martinez in Nogales, Sonora, for narcotics; that defendants had actually appeared in Nogales on June 5, 1967; that he had seen defendants in Mexico on the preceding night, June 6; and that defendants were then engaged in the rather singular episode of traveling *by taxicab* from Nogales apparently to Tucson, a distance of 67 miles over a route served by public bus transportation (RT 145-146). Accordingly, Dennis turned his vehicle and followed the taxicab, calling State Narcotics Agent Dunn by radio and asking him to pick up Customs Agent Anderson at Tucson and to meet him on the Nogales Highway (RT 146). About that time, Dennis received by radio from Agent Washington the information that Washington had obtained from the informer, viz: that narcotics dealer Martinez had returned to Nogales, Sonora, and had sold defendants narcotics for the sum of $4,000 (M RT 82).

When Agents Dunn and Anderson met Agent Dennis on the Tucson-Nogales Highway, the three agents followed defendants in their taxicab to the Tucson Greyhound Bus Depot (RT 146-147). There, as defendants were alighting from the taxicab, the agents identified themselves, "patted down" the defendants for weapons and, since a crowd was gathering, took them to the Tucson offices of the State Narcotics Agency, the defendants being transported in the car of Agent Dunn (RT 147-148). Dunn examined his rear car seat before the defendants got in to make sure the seat was empty in order to make sure there was nothing they could get their hands on (RT 224). After they got in the car and while waiting for Agent Dennis, Dunn saw Marshall place his hand under his

shirt and move his hand under his shirt to the right rear (RT 224). At these offices, the persons of the defendants were searched without result but, while the search was being conducted, Agent Dunn, whose eyes had not left his vehicle and who had called Dennis' attention to the package he saw on the seat after Defendants got out, examined his automobile and found, in the seat which defendants had occupied during the trip from the Greyhound Bus Depot, three packages of heroin (RT 226-227). When the heroin was brought to the room in which defendants were being searched, defendants were then informed that they were under arrest (RT 286). Agent-in-Charge Cameron gave this information to defendant Riley, informing him that he was under arrest for smuggling narcotics; that he did not have to make any statement; that any statement he might make could be used against him in court; that he was entitled to an attorney; and that if he could not afford one the Government would provide one for him (RT 286-287). At that time, defendant Riley started to speak to Agent Cameron and was advised by Cameron to keep silent. Nevertheless, defendant Riley said to Agent Cameron, "Did those Mexicans turn me in?" (M RT 83-84; RT 287) Then, addressing Agent Washington, defendant Riley said, "You don't give up, do you?" (RT 84)

Government's exhibit 22 contained 60% pure heroin weighing approximately 5.2 ounces (RT 268-269).

III.

OPPOSITION TO SPECIFICATIONS OF ERROR

1. There was evidence against both defendants of a crime shown.

2. There was circumstantial evidence of actual possession by defendant Marshall and of constructive possession by defendant Riley.

3. There was no error in admitting the five and one-half ounces of heroin into evidence.

4. There was no error in sustaining the Government's claim of privilege and refusing to order the Government to reveal the name of the informer.

5. There was no error in admitting into evidence the statement of Riley and no cautionary instruction to the jury.

6. There was no fatal variance between the dates set out in the Indictment and the proof adduced at the Motion to Suppress and at Trial.

7. There was no error in the Court's ruling the said heroin was abandoned.

8. There was no error in submitting the case to the jury against both defendants.

9. There was no error in denying defendants' Motion for New Trial or for Mistrial.

IV.

SUMMARY OF ARGUMENT

1. The two searches of defendants on June 5, 1967 and on June 6, 1967, were based upon probable cause.

2. There were no grounds given by defendants to override the Government's claim of privilege against revealing the name of the informer.

3. There was no error in admitting Riley's statement based on Government counsel's argument and the Court's instructions to the jury.

4. There was sufficient evidence as to both defendants for a jury to find proof of guilt beyond a reasonable doubt.

5. There was no error in Government counsel's argument.

6. There was no fatal variance between the dates charged in the Indictment and the proof adduced at trial.

V.

ARGUMENT

1. The two searches of defendants on June 5, 1967 and on June 6, 1967, were based upon probable cause.

Appellants argue lack of probable cause at pages 23 to 27 of their Opening Brief. The Trial Court issued a written opinion in ruling on the Motion to Suppress, entered and filed August 16, 1967 (RC Item 15). The Trial Court's Findings and Decision on Motion to Suppress covered eleven pages. The Findings will not be repeated but are set out in the Statement of Facts herein verbatim. The only additions to the Court's findings in the Statement of Facts are indicated by underlining and are the identification of the contents of Government's exhibit 22, the 5.2 ounces of 60% pure heroin, and Dunn's observations of the car seat and Marshall's movements. This testimony was not offered at the Motion to Suppress. Omitted from the Statement of Facts but contained in the Court's Findings was the following paragraph at the beginning:

> "In appraising the validity of the acts and conduct of the Customs officers which are involved in the Motion to Suppress in this case, it must be borne in mind that the officers know, as this court knows, that Nogales, Arizona, is one of the principal points on the United States-Mexico border at which the illegal importation of narcotics is constantly attempted, successfully and unsuccessfully; that in the year July 1, 1966, to June 30, 1967, over 200 arrests have been made for narcotics violations at Nogales, a very high per cent thereof resulting in convictions; and

that in connection with these arrests, very substantial amounts of heroin, marihuana, and other drugs have been seized at Nogales." (RC Item 15, 1st page)

At page 6 of the opinion after the Court found defendant Riley was carrying approximately $5,000.00 in cash, the Court found:

"The facts and circumstances within the knowledge of the Customs officers and of which they had reasonably trustworthy information at the time they stopped and detained the defendants at Marana were sufficient in themselves to warrant men of reasonable caution in the belief, and the officers did believe, that defendants were committing the offense of transporting narcotics which had been imported into the United States unlawfully and which the defendants knew had been imported unlawfully." (RC Item 15, page 6)

The Court, beginning at page 10, went on to find:

"The facts and circumstances within the knowledge of Agents Dennis, Anderson, and Dunn and of which they had reasonably trustworthy information at the time they stopped and took control of the movements of defendants at the Greyhound Bus Depot were sufficient in themselves to warrant men of reasonable caution in the belief, and the agents did believe, that defendants were committing the offense of transporting narcotics which had been imported into the United States unlawfully and which defendants knew had been imported unlawfully.

"The court concludes and holds as a matter of law:

"1. That the stopping and detention of the defendants by the customs officers at Marana, Arizona, on June 5, 1967, was an arrest of defendants, although defendants were not advised they were under arrest and although, in fact, they were advised that they would be arrested if contranband were found in their vehicle.

"2. That the arrest of the defendants and the search of defendants at Marana was valid and lawful.

"3. That acts of the agents in taking the defendants into custody at the Greyhound Bus Depot on June 7, 1967,

was an arrest, notwithstanding defendants were not informed that they were under arrest until after the heroin was found in Agent Dunn's automobile.

"4. That the arrest and search of defendants on June 7, 1967, was valid and lawful.

"5. That the heroin involved in this case was not found as the result of any search of defendants but was abandoned by defendants in Dunn's automobile and discovered by Dunn when he examined his automobile. Accordingly, the seizure of the heroin was valid and lawful and will not be suppressed.

"6. That the questions defendant Riley addressed to Agents Cameron and Washington at the Tucson offices of the Arizona narcotics agency on June 7, 1967, were voluntary acts on the part of defendant Riley, done against the advice of Agent Cameron, and were not the product of questioning by the agents, or any of them. Accordingly, such questions will not be suppressed.

"The premises considered,

"IT IS ORDERED that defendants' Motion to Suppress is denied." (RC Item 15, pages 10-11)

As was pointed out by Appellants' Opening Brief at page 23, *Brinegar v. United States* (1949) 338 U.S. 160, 93 L.Ed. 1879, 69 S.Ct. 1302, does contain a definition of probable cause. It is asserted that it is as good a definition as any. It is respectfully submitted that it is the U.S. Supreme Court's last word on it. See *McCray v. Illinois* (1967) 386 U.S. 300, 18 L.Ed. 2d 62 at p. 67, 87 S.Ct. 1056. At page 175, the Supreme Court states:

> ". . . Probable cause exists where 'the facts and circumstances within their [the officers'] knowledge and of which they had reasonably trustworthy information [are] sufficient in themselves to warrant a man of reasonable caution in the belief that' an offense has been or is being committed. *Carroll v. United States,* 267 U.S. 132, 162[15]."

The Trial Court found as set out above that the "facts and circumstances within the knowledge of" the arresting

agents "and of which they had reasonably trustworthy information at the time they stopped and took control of the movements of defendants at the Greyhound Bus Depot were sufficient in themselves to warrant men of reasonable caution in the belief, *and the agents did believe,* that defendants were committing the offense of transporting narcotics which had been imported unlawfully and which defendants knew had been imported unlawfully." (RC Item 15, page 10) (Emphasis supplied)

The Trial Court made this finding after finding facts describing what the agents had observed, either or both of defendants' movements in the Nogales-Tucson area, May 18 to June 6, 1967.

Appellants argue there should be corroboration of the informer's information. Surely the movements of defendants around Nogales, the hiring of a taxi from Nogales to Tucson, some 67 miles, when public bus transportation was available, and the defendants' own appearance which stood out in a small community like Nogales, Arizona, constituted corroboration.

Appellants then argue that the Trial Court weakened his finding of probable cause by the finding that the property was abandoned on the car seat. How this finding by the Trial Court weakens the Trial Court's finding of probable cause cannot be seen. Assuming for the sake of argument that the contraband was found on either of the defendants' person when the defendants had not been told they were under arrest, appellants would then be arguing that the form of the arrest not being lawful, therefore, the search incident thereto was not lawful.

In *Bailey v. United States* (5th Cir., 1967) 386 F.2d 1, at pages 2-3, the Fifth Circuit held:

> "As this was a warrantless search not incident to an arrest, the government either must have a finding that probable cause existed or must excuse its absence by resort to the border search doctrine. No case has held that one

who has not crossed an international boundary can be the object of a constitutionally permissible border search, and we do not reach that question. Rather, we assume the view of the searching officers, and hold that 'the facts and circumstances within their knowledge and of which they had reasonably trustworthy information were sufficient in themselves to warrant a man of reasonable caution in the belief' that appellants were, when searched, possessed of illegal narcotics."

It is respectfully submitted the search was based on probable cause and the testimony of the money on Riley's person on June 5, 1967, and the contraband seized on June 6, 1967, was properly admitted into evidence.

2. There were no grounds given by defendants to override the Government's claim of privilege against revealing the name of the informer.

Appellants argue that the identity of the informer should have been revealed by Defendants' Motion for Bill of Particulars or at the hearing on the Motion to Suppress, at pages 27 to 31 of the Opening Brief.

In the memorandum in support of the Motion for Bill of Particulars at page 2, defendants' counsel states:

> "In narcotics cases, the courts are especially liberal in ordering disclosure of the names of persons involved in the transaction. *United States vs. Vasquez,* 25 F.R.D. 350; *United States vs. Wilson,* 20 F.R.D. 350; *Roviaro vs. United States,* 353 U.S. 53, 1 L.Ed. 2d 639. It would appear since the Government, in its complaint filed against the above-captioned defendants, did not set forth when and in what cases the informant had been reliable in the past but ony made the general assertion that he had been reliable would not, in and of itself, appear to be sufficient evidence of his reliability, and therefore, his identity should be revealed." (RC Item 5)

No affidavit was filed in support of the Motion. In the memorandum, Counsel asserted the Complaint did not set out when and in what cases the previous reliability informant had given information (RC Item 5). The Complaint was filed after the arrest of the defendants. The Government is not limited to the contents of the Complaint in establishing the probable cause for an arrest. *Dearinger v. United States* (9th Cir., 1967) 378 F.2d 346 at page 347.

At the hearing on the Motion to Suppress defendants' counsel sought the revelation of the identity of the Informant again. (See M RT 47, L 4-5, where the Government's counsel claimed the privilege.)

No grounds for setting aside the privilege were shown at the time of the Motion for Bill of Particulars much less at the hearing of the Motion to Suppress.

In *Roviaro v. United States* (1957) 353 U.S. 53, at p. 62, 1 L.Ed. 2d 639, 77 S.Ct. 623, the Supreme Court stated:

> "We believe that no fixed rule with respect to disclosure is justifiable. The problem is one that calls for balancing the public interest in protecting the flow of information against the individual's right to prepare his defense. Whether a proper balance renders nondisclosure erroneous must depend on the particular circumstances of each case, taking into consideration the crime charged, the possible defenses, the possible significance of the informer's testimony, and other relevant factors."

In *Sabbath v. United States* (9th Cir., 1967) 380 F.2d 108 at page 110, this Court stated:

> "[2-4] Information from an informer not known to be reliable does not constitute probable cause for an arrest without a warrant. If, however, by the time of the arrest there has been such corroboration of the informer's information to warrant a man of reasonable caution in the belief that an offense has been or is being committed, then probable cause does exist.[3]"

In *McCray v. Illinois* (1967), *supra,* the Supreme Court sustained the claim of privilege in a case decided after *Sabbath v. United States, supra,* where the informant was shown to be previously reliable and the information was credible and the agents believed the information in good faith.

It is respectfully submitted there were and are no grounds to override the Government's claim of privilege against revealing the name of the Informant.

3. There was no error in admitting Riley's statement based on Government counsel's argument and the Court's instructions to the jury.

There is no argument in support of Appellants' Specification of Error Number 9, i.e., "That error was committed in the admission of these statements without a cautionary instruction that the said statements could not be used by the jury against appellant MARSHALL."

At the time the statement of Riley was to be offered, Government's counsel asked for a hearing outside the presence of the jury (RT 277, L 8-22). The hearing on the voluntariness was held (RT 277-285). The contents of that statement was gone into several times (RT 280, L 14-17; 282, L 4-8; 284, L 10-12; 284, L 20-23). No such request was raised by defendants' counsel at the voluntariness hearing (RT 277-285), and the only objection raised by him was voluntariness (RT 282, L 22 to 283, L 20). When the statement was offered in the presence of the jury, no request for such instruction was made by defendants' counsel:

(By Miss Diamos) "Q Then what was said?

"A At that time Mr. Riley looked at me and—

"MR. HEALY: Excuse me. Could the record indicate my objection to the testimony?

"THE COURT: Yes, and the objection is overruled.
"Q (By Miss Diamos) What did Riley ask you?"
RT 287, L 6-11)

Appellants' counsel cannot argue that the statement in the presence of the jury took him by surprise since its contents were gone into four times in the voluntariness hearing.

The Government's counsel argued statement against Riley only (RT 300, L 15-19; 319, L 20-23; 322, L 5-10).

Since Appellants' counsel has not argued this point in its opening brief, no further argument can be made. Suffice it to say, the Trial Court instructed the Jury to consider the evidence as only against the person against whom it was admitted (RT 324, L 5-10; 341, L 1-5) and to determine the guilt or innocence of each defendant separately (RT 324, L 7-9; 340, L 23 to 341, L 5). *Russell G. Courtney v. United States of America* (9th Cir., March 1, 1968) No. 20769 at pages 15-18.

It is respectfully submitted there was no error in the Trial Court not instructing the jury at the time the statement was received to consider it only against Riley.

4. There was sufficient evidence as to both defendants for a jury to find proof of guilt beyond a reasonable doubt.

At pages 15 to 23 of Appellants' Opening Brief, Appellants' counsel argues the sufficiency of the evidence. The State Agent Joe Dunn testified to checking his car seat at the Greyhound Bus Depot in Tucson, Arizona, before defendants entered it to make sure there was nothing the defendants could seize (RT 224-226). He was watching them, while waiting for Agent Dennis to walk around to the passenger seat, and saw Marshall, who was sitting on the right hand side put his hand underneath his shirt and move his hand under his shirt to the right rear and as Dennis got in heard Dennis tell

them "put your hands on your knees." (RT 226-227) When they arrived at the State Office Building, he noted seeing the package as the Defendants got out and kept his eyes on the car until he recovered the package (RT 226-228). Surely, this is circumstantial evidence of the actual possession by Defendant Marshall. The evidence on appeal must be construed in the light most favorable to the Government. *Glasser v. United States* (1942) 315 U.S. 60, 62 S.Ct. 457, 86 L.Ed. 680; *Schino v. United States* (9th Cir., 1953) 209 F.2d 67 at p. 72.

This, coupled with Marshall's movements on June 5 and 6, 1967, as set out in the facts are sufficient to find proof beyond a reasonable doubt.

Defendant Riley's statement at the time of arrest, after Cameron had advised him as to his rights and had cautioned him to remain silent as he tried to speak, "Did those Mexicans turn us in?", was surely sufficient when viewed with the evidence of his movements from May 18, 1967, and on through June 6, 1967, including his possession of approximately $5,000.00 in cash the day before, the change in the rented cars on June 5 and June 6, 1967 (RT 31, L 24 to 32, L 1; 66 L 16-17; 76, L 11-14; 93-95). Riley gave the reason on turning in the yellow Mustang that it wasn't running right, but three cars were rented in the space of two days. What was this but an attempt to keep themselves from being detected.

It is respectfully submitted there was more than sufficient evidence upon which to return a verdict of guilty as to both defendants beyond a reasonable doubt.

5. There was no error in Government counsel's argument.

At pages 32 to 34 of Appellant's Opening Brief, Appellants' counsel argues the allegedly prejudicial statements of

Government's counsel in opening argument as being a "gross and direct referral to the fact of this failure to testify is too obvious for comment." Then Appellants' Counsel goes on to argue that Government's counsel committed prejudicial error in stating:

> "Why did they go away from the Border? Why did it take them so long to make the connection, pick up this five ounces of heroin? Well, I submit to you it's logical to argue that that amount of heroin is not easily available even in Nogales, Sonora.
>
> "MR. HEALY: I object to that, your Honor. There is no evidence of that.
>
> "THE COURT: That is outside the record.
>
> "MISS DIAMOS: Your Honor, it was just on the basis—very well." (RT 303, L 16-25)

At the close of Government's Opening Argument, defendants' counsel approached the bench and moved for a mistrial on three grounds (RT 305, L 10-23); the first on allegedly commenting on defendants' failure to testify; the second that five ounces of heroin was a large amount and they would have to wait around to obtain it, and the third, that they were going to take it back to sell it.

With regard to the Government's counsel allegedly commenting on defendants' failure to testify, the statement of Government's counsel should be set in context. From page 289 to 292 of Government's Opening Argument, Government's counsel argued or reviewed what she believed the Court's instructions would be. It was as follows:

> "MISS DIAMOS: May it please the Court, Mr. Healy, ladies and gentlemen of the jury: As you were told before and have been told many times, but as the Court will probably caution you in the instructions, and it's good to repeat it at the opening of every statement by an attorney, what is said by an attorney—either at the time of the opening statement at the beginning of the case or at the

time of argument at the close of the case—is not evidence. It's the testimony of the witnesses and the exhibits that have been admitted into evidence. It isn't that any attorney would try to mislead you; it's that people recall and retain differently, and under the laws of our nation you are the sole judges of the facts and it is what you recall the evidence you heard that will constitute the facts in this case, and not what Mr. Healy, for instance, or myself recall. It's the testimony as you heard it.

"As in any case, civil or criminal, the party who has the burden of proof—that is the plaintiff, the party bringing the action—opens the argument and then closes the argument and rebuts anything the defense brings out in its argument. And in a criminal case the Government bears the burden of proof beyond a reasonable doubt. The Court will instruct you as to the law and as to what reasonable doubt is. The Court will also instruct you as to the elements of the offense." (RT 289, L 6 to 291, L 5)

The Trial Court instructed as follows:

"Heroin is a narcotic drug within the meaning of the statute, and heroin is imported or brought into the United States contrary to law if it is imported or brought in without the Secretary of the Treasury, the Federal Officer, having authorized its importation for delivery to officials of the United Nations, officials of the Government of the United States or officials of the several states of the United States or to any person licensed by the Federal Government for scientific purposes only. In other words, heroin may not lawfully be brought into the United States unless the Secretary of the Treasury has issued a permit for its importation to officials of the United Nations, officials of the United States, officials of a state of the United States, or to a person licensed by the Federal Government to import the heroin for scientific purposes only." (RT 330, L 17 to 331, L 7)

The Trial Court then went on to define and give the elements of both counts. The Trial Court then instructed as follows:

"As to the offense charged in Count Two of the Indictment, I instruct you that when an accused on trial is proved beyond a reasonable doubt to have had possession of heroin, such possession authorizes the jury to draw an inference that the heroin was imported contrary to law and to draw a further inference that such accused had knowledge of such unlawful importation.

"These inferences, if drawn, may be overcome, however, if from the evidence which has been received in this case you are satisfied that the possession of the heroin by the accused did not involve a violation of the statutes either because the heroin was not imported contrary to law or because the accused had no knowedge of its unlawful importation." (RT 337, L 19 to 338 L 6)

It is respectfully submitted the statement of Government's counsel in context does not in any sense constitute a comment on defendants' failure to testify.

With regard to the allegedly prejudicial statement that the five ounces of heroin wasn't available in Nogales, Sonora, was prejudicial, it is respectfully submitted the Court sustained defendants' counsel's objection and told the Jury no basis for it was in the record. However, as shown in the quoted portion above, what counsel was trying to explain was that this was a logical inference from the passage of time that defendants spent in the Nogales area.

In *Washington v. United States* (5th Cir., 1964) 327 F.2d 793, the Government's counsel argued in a case in which the evidence was weak that the government agent acted as an undercover buyer at the risk of his own life and that the people have a right to be secure in their own homes. The Fifth Circuit reversed because of the weakness of the Government's case.

It is respectfully submitted the statements of counsel did not constitute error and if they did, the Government's case was not weak.

6. There was no fatal variance between the dates charged in the Indictment and the proof adduced at trial.

At page 22 of Appellants' Opening Brief, Appellants' counsel argues there was a fatal variance from the proof adduced at trial as compared to the opening date charged in the Indictment, i.e., "Commencing on or about May 26, 1967, and continuing . . ." (RC Item 1, page 1, Line 11).

The proof as to what occurred on May 17 and May 18, 1967, was offered at the time of the hearing on the Motion to Suppress, that is, on August 11, 1967 (M RT 1, L 19). The trial commenced September 8, 1967 (RT 4, L 18).

Defendants' counsel cannot argue surprise as a basis of alleging fatal variance. This was not raised at the hearing on the Motion to Suppress, at trial, nor at the Motion for New Trial.

The difference in dates amounts to nine days. The proof need not establish with certainty the exact date of the alleged offense. It is sufficient if the evidence in the case establishes that the offense was committed on a date reasonably near the date alleged. *Ledbetter v. United States,* 170 U.S. 606, 612, 18 S.Ct. 774, 776, 42 L.Ed. 1162 (1898).

It is respectfully submitted there was no fatal variance on the opening date as alleged in the Indictment and the proof offered at trial.

VI.

CONCLUSION

It is respectfully submitted there was sufficient evidence properly received at trial to find both defendants guilty of both counts, and the argument of Government's counsel was not error.

Respectfully submitted,

EDWARD E. DAVIS
United States Attorney

Jo Ann D. Diamos
Assistant United States Attorney
Attorneys for Appellee

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing Brief is in full compliance with those rules.

Jo Ann D. Diamos
Assistant United States Attorney

Three copies of the Brief of Appellee mailed this 29th day of March, 1968, to:

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IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

VELTON WATKINS, Appellant, vs. LOUIS S. NELSON, Warden, California State Prison, Tamal, California, Appellee.	)	No. 22512

APPELLEE'S BRIEF

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APPELLEE'S BRIEF

JURISDICTION

The jurisdiction of the United States District Court, Northern District of California, to entertain appellant's application for writ of habeas corpus was conferred by Title 28, United States Code, section 2241. The jurisdiction of this Court is conferred by Title 28, United States Code section 2253.

STATEMENT OF THE CASE

A. Proceedings in the State Courts.

On December 13, 1965, in an action entitled The People of the State of California v. Velton Watkins, petitioner was found guilty of murder in the first degree in violation of California Penal Code section 187. San Joaquin County Superior Court No. 17270. Appellant was sentenced to state prison for life.

Timely notice of appeal was filed in the

California Court of Appeal, Third Appellate District 3/Crim. No. 4114. Appellant's Opening Brief was filed by appointed counsel on June 8, 1966 and respondent's brief filed by the Attorney General on August 29, 1966.

On February 17, 1967, the California Court of Appeal affirmed appellant's judgment of conviction. People v. Watkins, 248 Cal.App.2d 603, 56 Cal.Rptr. 734 (1967). A hearing was denied by California Supreme Court (1967).

B. Proceedings in the Federal Courts.

Appellant's only application for relief in the federal courts by way of his petition for writ of habeas corpus filed August 8, 1967 in the United States District Court, Northern District of California, and numbered 47617. An order to show cause was issued on August 9, 1967 and a return filed by the California Attorney General on August 28, 1967. Records of the proceedings in the state courts were considered by the District Court judge and the petition was denied on November 13, 1967. A certificate of probable cause to appeal and permission to proceed in forma pauperis issued on December 28, 1967.

STATEMENT OF FACTS

The relevant facts of this case, which are not in dispute, are contained in the decision of the California Court of Appeal affirming appellant's judgment of conviction. People v. Watkins, 248 Cal.App.2d 603; 56 Cal.Rptr. 734 (1967). Appellant and his codefendant, Foster, were

charged with first degree murder. Foster was also charged with assault with a deadly weapon.

Four eye witnesses testified that appellant and Foster attacked the victim in a "skid row" section of Stockton, California. Foster repeatedly struck the victim on the head with a crowbar. When the victim attempted to escape, he was seized by appellant. Foster and appellant then dragged the victim to a vacant lot where he was again struck with the crowbar by Foster while appellant stood by. A policeman was directed to the scene by witness and found the victim lying face down in a pool of blood, his empty wallet beside him and his pockets turned inside out.

Nearby, Foster was observed armed with a crowbar and pursuing one Jose Vargas. He was arrested. There was blood on the crowbar and blood on his clothing. Appellant was found and arrested in a nearby bar.

Prior to the murder trial, Foster pleaded guilty to the Vargas assault. During the course of trial, in addition to the evidence related above, the prosecution introduced the testimony of Vargas and several witnesses concerning the crowbar attack upon Vargas by Foster. Appellant was not implicated in the attack upon Vargas. Both defendants testified at trial. Each admitted that he had been in the neighborhood and knew his codefendant. Each denied participation in the crime. Neither implicated the other.

APPELLANT'S CONTENTIONS

1. Appellant was deprived of adequate representation by counsel at trial.

2. Appellant was deprived of his rights to individual counsel and a separate trial.

SUMMARY OF APPELLEE'S ARGUMENT

I. The District Court correctly determined that no conflict of interest existed between appellant and his codefendant and that appellant was adequately represented by counsel.

II. Appellant was neither entitled to separate counsel nor a separate trial.

ARGUMENT

I

THE DISTRICT COURT CORRECTLY DETERMINED THAT NO CONFLICT OF INTEREST EXISTED BETWEEN APPELLANT AND HIS CODEFENDANT AND THAT APPELLANT WAS ADEQUATELY REPRESENTED BY COUNSEL.

Appellant contends that the trial court erred in allowing the prosecution to present evidence of the attack upon Vargas by Foster after Foster had pleaded guilty to the assault. He contends that evidence of the assault by Foster created a conflict of interest between himself and Foster which prohibited the public defender from adequately representing either defendant. As noted by the District Court Judge in his order denying the petition, appellant's claim of a conflict of interest is based upon his contention that if defense counsel requested an

admonition that the evidence of the assault upon Vargas be admitted only against Foster, Foster was prejudiced. If he failed to request such an admonition, appellant was prejudiced.

Initially, respondent submits that the evidence of the attack upon Vargas by Foster in no way implicated appellant. Despite counsel's failure to request that the jury be admonished that the evidence of the Vargas attack be considered only against Foster, the court did, in fact, instruct that the evidence was received for the limited purpose of establishing the innocence or guilt of Foster. As noted by the California Court of Appeal,

> "The quoted instruction conveyed to the jury the unmistakable direction that evidence of the Vargas incident was received for a limited purpose only, that such purpose had to do with the defendant Foster and that the jurors were not permitted to consider it for any other purpose. After receiving this instruction, the jury could not reasonably weigh evidence of the Vargas incident in relation to the guilt or innocence of appellant Watkins."

Appellant asserts that the court erred in allowing the prosecution to introduce evidence of Foster's attack upon Vargas because Foster entered a plea of guilty to the charge of assault with a deadly weapon before the trial

began. He relies upon California Penal Code section 1025 for the proposition that evidence of a prior crime may not be introduced during trial for a separate offense.

Initially appellee submits that, except insofar as this evidence served to prejudice appellant, he is without standing to raise this contention. For the reasons stated above, no prejudice resulted. Secondly, the evidence was properly admissible as it tended to prove that Foster participated in the murder for which he was being tried. The similarity of the attack and the proximity in both time and distance from the murder strongly indicated that Foster was one of the murderers. The evidence was thus admissible despite the fact that it concerned another crime. Cal. Evid. Code § 1101(b); See People v. Peete, 28 Cal.2d 306, 315-316 (1946).

Each defendant testified in his own behalf. Each denied any participation in the murder. Neither implicated the other. No conflict of interest was urged by defense counsel and none is reflected by the record. The jury was fully apprised of appellant's defense which was in no way undermined by that of his codefendant.

The record contains overwhelming evidence of appellant's guilt. He has not alleged and the record fails to indicate any available defense which counsel failed to present. See Dalrymple v. Wilson, 366 F.2d 183 (9th Cir. 1966); Cf. Wilson v. Rose, 366 F.2d 611 (9th Cir. 1966). The burden was upon appellant to establish that the

representation afforded him rendered the proceedings a farce, a sham and a mockery of justice. Knowles v. Gladden, 378 F.2d 761, 767 (9th Cir. 1967); Grove v. Wilson, 368 F.2d 414, 416 (9th Cir. 1966); Dalrymple v. Wilson, supra at 185. Appellee submits that appellant has failed to sustain the burden and the District Court properly denied his application for habeas corpus.

II

APPELLANT WAS NEITHER ENTITLED TO SEPARATE COUNSEL OR A SEPARATE TRIAL.

Having determined that there was no conflict of interest, appellee submits that appellant's remaining contentions are without merit. Appellant contends that he was deprived of the right to independent counsel. In the absence of a conflict of interest between codefendants, there is no right to independent counsel. Glasser v. United States, 315 U.S. 60 (1942); Lugo v. United States, 350 F.2d 858 (9th Cir. 1965).

Nor was appellant entitled to a separate trial. California Penal Code section 1098 specifically provides that when two or more defendants are jointly charged with any public offense, they must be tried jointly, unless the court orders separate trials. This determination is within the discretion of the trial court. The record reflects that a motion for separate trials was made by defense counsel at the beginning of trial but that no conflict of interest was established. There is no federal constitutional right to separate trials and, in the absence of

[illegible]

[illegible]

[illegible]

[illegible]

a conflict of interest, the exercise of discretion of the trial judge will be sustained. Delli Paoli v. United States, 352 U.S. 232 (1957); United States v. Ball, 163 U.S. 662 (1896).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the District Court correctly determined that petitioner was deprived of no federally protected constitutional rights and that the order denying the petition for writ of habeas corpus should be affirmed.

DATED: May 13, 1968

THOMAS C. LYNCH, Attorney General
of the State of California

ROBERT R. GRANUCCI
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CERTIFICATE OF COUNSEL

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit and that in my opinion this brief is in full compliance with these rules.

DATED: May 13, 1968

James B. Cuneo

JAMES B. CUNEO

Deputy Attorney General
of the State of California

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 21512

CLINTON ROY PETRIE,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

PETITION FOR REHEARING

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 21512

CLINTON ROY PETRIE,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

PETITION FOR REHEARING

Comes now the appellant, by his attorney, and files this his Petition for Rehearing of Judgment entered by the Court on May 21, 1968, affirming the judgment of the Court below.

Appellant respectfully asks that the decision of May 21, 1968, be reheard by an en banc Court,* for the reason that essential portions of it are contrary to recent holdings of this Court, particularly *Miller* v. *United States*, 9th Cir., 1967. *Miller* is not mentioned. It is to be recalled that

---

*Counsel has never before made such a request in any of the several score matters he has had before this Court.

this case (*Petrie*) was argued in the Fall of 1967, before the *Miller* decision was decided by another panel.

Appellant reserves his argued position as to each of the points of appeal, but in this petition addresses himself solely to certain features of the decision wherein he believes the Court may be convinced its opinion should be revised.

I

THE III-A SITUATION

There are two subdivisions to this point, and both merit further thought.

A. The fact that the local board withheld pertinent information from the appeal board.

The Court said:

> "It is appropriate first to dispose of the contention that 'the appeal board improperly classified appellant I-O in June, 1965, because the local board failed to notify . . . [the appeal board] of the intervening facts that removed appellant from consideration for Class I-O and entitled him to classification in Class III-A.'" [Slip op., p. 61].

The Court disposed of appellant's contention by referring to the regulations, as follows:

> "Since the appeal board would have been precluded from considering any such additional information outside the record forwarded to it at the time of the appeal, this contention is devoid of merit. 32 C.F.R. §§ 1626.14, 1626.24 (b)."

Assuming that it is correct that the appeal board can at any one occasion, only consider what comes initially from the local board the dereliction of the local board is nevertheless clear because the record shows that this appellant's processing, by the local board, continued for more than a year thereafter; that the local board, therefore, had more opportunities to see that the new information presented by Petrie went to the appeal board so that this registrant could have had an appellate determination on the June, 1965, "intervening facts" pertaining to this III-A hardship claim [Government Exhibit, pages 12-13, the Minutes of Action].

B. The failure of the local board to reopen.

The Court said "We turn, therefore, to Petrie's contention that, assuming the truth of the facts presented to the local board, the decision not to reopen his classification was improper."

"Our scope of review over the local board's classification decision is well defined. However strongly we may disagree with the appropriateness of the local board's classification decision, we may overturn the classification only if it has 'no basis in fact.'" [Slip op., p. 6].

The Court is asked to reconsider this failure to reopen because the decision is in direct conflict with *Miller* v. *United States*, 9 Cir., 1967, 388 F.2d 973. In *Miller* it was pointed out that the no-basis-in-fact doctrine is not applicable to a reopening situation, but only to a classification situation.

II

THE II-A SITUATION

The court used an incorrect standard in rejecting appellant's claim.

A. The court said:

> ". . . it was not demonstrated that he could not be replaced." [Slip op., p. 8].

Where does the law require "demonstration"? This is an impossible burden and an unheard of one until now.

The law requires only a prima facie showing. *Dickinson* v. *United States,* 74 S.Ct. 152 (1953). There is nothing in the record to diminish the appellant's prima facie showing. The *Petrie* decision is also contrary to the principle stated by this Court in *Franks* v. *United States,* 9 Cir., 1954, 216 F.2d 266: ". . . we must view the record in the light most favorable to the appellant . . ." [269].

B. The court concluded:

> ". . . it would yet remain necessary for the board to find that the character of the occupation was such as to make the registrant's continued pursuit of it 'necessary to the maintenance of the national health, safety, or interest.' We hold that there was justification for the determination that the occupation of flight instructor at the Valley Pilots Flying Service was not an occupation 'necessary to the maintenance of the national health, safety, or interest.'" [Slip. op., p. 8].

No citation is given for the conclusions above stated, namely, (1) that the board was required to make an affirmative finding or (2) that there was "justification"

for the implied finding of the board that flight instruction was not an occupation valuable to the national interest. The record showed that the Valley Pilots Flying Service met the requirements of the law (32 C.F.R. § 1622.23 (a)) with the required factual allegations (Ex. 143).

It is common knowledge (1) that pilots, especially helicopter pilots are a national need, because of the Vietnam demands and (2) that civilian needs, such as the demands of the Gulf of Mexico oil work must be met; moreover, the record supports this "common knowledge" statement (Ex. 143-144).

III

THE II-S SITUATION

Here again we are faced with a reopening situation, as distinguished from a classification situation and we again argue that *Miller*, supra, controls.

Here again the Court based its decision on the inapplicable no-basis-in-fact doctrine.

Counsel further represents and certifies: In counsel's judgment this Petition is well founded and is not interposed for delay.

Respectfully submitted,

J. B. Tietz
Attorney for Appellant

December 19, 1968.

NO. 22513

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

STEVEN B. MEDVED,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

FILED

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

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IN THE UNITED STATES COURT OF APPEALS

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APPELLEE'S BRIEF

I

STATEMENT OF JURISDICTION

On February 1, 1967, appellant was indicted in one count by the Federal Grand Jury for the Central District of California for concealment of assets from a trustee in bankruptcy in violation of Title 18, United States Code, §152 [C. T. 2]. 1/ Following a trial by jury before the Honorable Irving Hill, United States District Judge, from August 29, 1967 to September 1, 1967, appellant was found guilty.

Appellant was convicted and sentenced, on September 25, 1967, to the custody of the Attorney General for a period of

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1/ "C. T." refers to Clerk's Transcript.

two years, and on the condition that six months be served, the remainder of the sentence was suspended and the appellant placed on two years probation [C. T. 59].

Medved filed, on September 29, 1967, a timely Notice of Appeal [C. T. 64].

The District Court had jurisdiction under the provisions of Title 18, United States Code, §§152 and 3231.

This Court has jurisdiction to review the judgment pursuant to Title 28, United States Code, §§1291 and 1294.

II

STATUTE INVOLVED

Title 18, United States Code, §152, provides in pertinent part:

> "Whoever knowingly and fraudulently conceals from the . . . trustee . . . in any bankruptcy proceeding, any property belonging to the estate of a bankrupt . . .
>
> "Shall be fined not more than $5,000, or imprisoned not more than five years, or both."

III

QUESTIONS PRESENTED

A. Whether statements of Medved should have been admitted into evidence under Kohatsu v. United States.

B. Whether the trial court erred in not giving two instructions.

IV

STATEMENT OF FACTS

On August 24, 1964, Medved filed his schedules in bankruptcy in the Central District of California, and showed "Cash on Hand" - "NONE" [R.T. 161, 163-64]. 2/ Appearing in the schedule of assets and liabilities is the usual oath that the schedules contain all property [Ex. 1, 165-167]. Outside of a cause of action, the trustee eventually received only a sales tax bond refund of $4.39 [R.T. 168].

On August 7, 1964, Medved went to the Palm Springs National Bank, presented 82 checks [R.T. 265] and in return received $1,254.84 in cash, and a cashier's check in the amount of $3,000 [R.T. 205, Exhibits 3 and 5]. The $3,000 cashier's check was negotiated by Medved on August 14, 1964 for a $2,000 cashier's check [Ex. 19] and $1,000 in cash [R.T. 200-01]. The $2,000 cashier's check was negotiated by Medved on August 24, 1964, (the date of filing for bankruptcy) for a $1,000 cashier's check [Ex. 20] and $1,000 in cash [R.T. 202-93]. The $1,000 cashier's check was cashed by Medved on September 8, 1964 [R.T. 203]. The various cashier's checks were kept at the bank

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2/ "R.T." refers to Reporter's Transcript.

until the underlying checks had cleared [R. T. 255-57]. When Medved originally presented the 82 checks for encashment he said he did not want to open an account under his name because "He was afraid there would be attachments against the funds" [R. T. 265]. The checks themselves were dated from July 20, 1964 to August 7, 1964 [R. T. 280].

On August 7, 1964, Verna Stearns gave Medved a $1,300 check for the remaining inventory of his nursery, but when she tried to stop payment within fifteen to thirty minutes, the check had already been cashed by Medved [R. T. 362, 365-66, 372, 374].

From approximately July 10, 1964, until the close of business, Medved was selling his nursery stock for less than 1/6 retail at other places [R. T. 292]; gave no receipts [R. T. 298, 314-15, 326]; preferred cash [R. T. 314]; was not told to hold the checks [R. T. 327, 341]; and was selling at less than wholesale [R. T. 340, 371].

Medved was described by a local banker as being "pretty astute" in his business dealings, as "a pretty shrewd businessman" [R. T. 386-87], and as displaying no difficulty in reading [R. T. 388].

On May 18, 1965, J. Clayton Taylor of the FBI, interviewed Medved, along with his wife Margaret [R. T. 421]. Prior to that time Taylor had found 75 checks cashed by Medved at the Palm Springs National Bank made out to cash, Steve Medved and Steve's Nursery [R. T. 84]. For the most part the books of the business did not reflect the sale [R. T. 84]. At that time

Taylor had no information as to whether the monies received by Medved had been spent prior to the filing of the schedules [R. T. 86-87]. At the hearing on the motions to suppress, the defense stipulated that the advice of constitutional rights stated in the FBI reports was made [R. T. 91]. Admittedly, Taylor did not advise Medved that he could have an appointed attorney present at the interview, but in any event, Medved was able to obtain retained counsel, as shown by his representation at trial.

At the interview of May 15, 1965, Medved said he closed the doors of the business on July 23 or 24, 1964, and the only sale in August was of some stepping stones [R. T. 423-24]. Medved said there was no inventory when the doors were closed on July 23 or 24 [R. T. 424]. Medved said he had no cash on hand when he went into bankruptcy [R. T. 426, 429], had made no trips, did no gambling, paid no large bills, and made no gifts during the period [R. T. 428]. At the interview Medved made no mention of the sale to Stearns or the checks cashed at the Palm Springs National Bank [R. T. 433].

Medved was again interviewed on November 1, 1965, and was informed of the location by Taylor of the checks cashed at the bank on August 7, 1964 [R. T. 434]. When asked what happened to the proceeds Medved said, "I don't know" [R. T. 434]. The same response was made to the question of why the proceeds weren't listed on the bankruptcy schedules [R. T. 434]; but he did say he didn't know they had to be listed [R. T. 434-35]. At the earlier interview he said he had no cash when the schedules were

filed [R.T. 437]; and everything was listed [R.T. 438]. At that earlier interview Medved stated -- "His statement to me was that he had nothing. His furniture had been repossessed. All he had was those items he moved, the Cadillac, the trailer, the tractor, and I believe he said a wheelbarrow and garden tools." [R.T. 438.]

At the trial Medved testified in his own defense. He stated he did not intend to cheat the trustee [R.T. 477], but he did have money when he went into bankruptcy [R.T. 494]. He said he lied to the FBI because he was afraid [R.T. 495, 500]. He said he relied on his wife and bookkeeper "for any kind of guidance" in legal and business problems [R.T. 505] (But see, R.T. 568, 569, 572, 584, relative to their degree of participation in his business affairs).

Medved testified he did not know he had to list his money, and the attorney, James Hollowell, did not tell him cash had to be listed or ask him if he had any cash [R.T. 510, 512, 513].

Medved testified that he had kept his own books in the past when he operated two bars in Ohio [R.T. 514-15].

On cross examination, Medved testified that he started dealing in cash because he didn't want his creditors to get the money [R.T. 518], even though he knew his creditors would get his assets through bankruptcy [R.T. 521]. The money was hidden so the creditors couldn't get it [R.T. 524].

Even though the checks cashed on August 7, 1964, were from the business [R.T. 530], Medved did not think it was "all

right to hide that $4,200 from [his] creditors . . . " [R.T. 534.]

After the Medveds testified as to their ignorance of their obligations, James M. Hollowell, a member of the bar of the States of California and North Carolina, and the attorney under whose direction the schedules in bankruptcy were prepared and filed, testified [R.T. 605]. Hollowell specifically explained bankruptcy to both Medveds [R.T. 607, 608]. Both Medveds told him there was only enough cash to pay Hollowell's fees, the filing fees, and another $100 [R.T. 609]. Hollowell specifically told both Medveds that cash had to be listed along with all other assets [R.T. 610-11]. He did not tell them that they could keep cash for living expenses [R.T. 611]. Hollowell went over each blank in the schedules with both Medveds and specifically asked them about each category [R.T. 613-14].

Even though Medved had testified that he didn't know what was on the schedules, Hollowell's secretary, Mary Dracsko, testified that she had a specific recollection of Steven Medved giving the answers which appear on the schedules (Ex. 1) [R.T. 643].

V

ARGUMENT

A. KOHATSU V. UNITED STATES ALLOWS THE ADMISSION OF THE SUBJECT STATEMENTS

Appellant relies on Turzynski v. United States, 268 F. Supp. 847 (N.D. Ill. 1967), for the proposition that a full Miranda warning is needed in the instant case for the admission of Medved's statements of May 18 and November 1, 1965. Turzynski is clearly not the law of this Circuit.

In the instant case Taylor appeared, identified himself, stated the purpose of his call, and advised Medved of his rights, without reference to a free attorney or the right to have one present during the interview. It is clear that Taylor was trying to determine if a crime had been committed.

It is noted that the defense conceded voluntariness in the instant proceedings [R. T. 140]. It is also noted that this trial court found that the case had not reached the accusatory stage at the time of the interviews [R. T. 139].

Kohatsu v. United States, 351 F. 2d 898 (9th Cir. 1965), cert. den. 384 U. S. 1011, reh. den. 385 U. S. 891, states the law of this Circuit, if not the law of the various circuits. For the same reasons stated therein, the instant interviews are admissible. It is noted that Kohatsu has been followed with very few exceptions, namely, Turzynski and two or three other cases. The following well-reasoned cases are illustrative of the fact that

Kohatsu is the law. United States v. Squeri, 398 F. 2d 785, 790 (2nd Cir. 1968); White v. United States, 395 F. 2d 170, 173 (8th Cir. 1968); Feichtmeir v. United States, 389 F. 2d 498, 504 (9th Cir. 1968); Rickey v. United States, 360 F. 2d 32 (9th Cir. 1966), cert. denied 385 U.S. 835. It is also noted that the Ninth Circuit has previously considered Turzynski in Whitfield v. United States, 383 F. 2d 142 (9th Cir. 1967) and paid it little heed.

B. THE TRIAL COURT PROPERLY INSTRUCTED THE JURY

1. Appellant's instruction on turning over assets is not the law and should not have been given.

Appellant submitted an instruction relative to "turning the assets over to the trustee" and "knowledge of an obligation to turn over all of his assets to the trustee." He urges that failure to so do was prejudicial to his defense, relying on Strauss v. United States, 376 F. 2d 416 (5th Cir. 1967), and Salley v. United States, 253 F. 2d 897 (D. C. Cir. 1965), neither of which apply to bankruptcy or the offered instruction. The cases relied upon by Medved state that the trial judge has the duty of determining first of all, whether such "theory" is a defense. Here, such is not the case. The relevant defendant's duty was to list his assets, not turn them over. A failure to list is concealment within the statute. United States v. Young,

339 F. 2d 1003 (7th Cir. 1964); Caghlan v. United States, 147 F. 2d 233 (8th Cir. 1945), cert. den. 325 U.S. 888, reh. den. 326 U.S. 805.

While the proposed instruction may have been a theory, it was not a defense. Knowledge of an obligation to turn over assets is simply not relevant to the instant charge.

2. The trial court properly instructed on reasonable doubt.

The Court's instruction on reasonable doubt appears at pp. 735-36 of the Reporter's Transcript, and states, in part:

> ". . . Evidence, in order to convince you beyond a reasonable doubt of a defendant's guilt must be such as you would be willing to act upon in the most important and vital matters relating to your own affairs . . . "

Appellant offered the following instruction instead:

> ". . . It (a reasonable doubt) must be sufficient to cause a reasonably prudent person to hesitate to act in the more important affairs of his life."

While the proper definitions and explanations are elusive, appellant cites McGill v. United States, 348 F. 2d 791 (D. C. Cir. 1965) and its observation that sometimes people act under pressure in their important affairs, and a definition of the doubt is better than a definition of the conviction needed for conviction.

It is noted that the instruction given refers to a "willing" decision while the offered instruction refers to a causal hesitation. In McGill, the Court said both "causal hesitation" and "willing conviction" instructions together are confusing, but nevertheless refused to reverse the conviction. In Jones v. United States, 338 F. 2d 553 (D. C. Cir. 1964) the Court said "We think this section of the charge should have been in terms of the kind of doubt that would make a person hesitate to act . . . rather than the kind on which he would be willing to act," at 555.

In the instruction given herein, the definition is of "evidence" and not "an abiding conviction of . . . guilt", as in Jones, or of "doubt." Judge Hill did not speak of the kind of doubt under which one operates but the kind of proof.

The problem, as conceived in the D. C. Circuit, is with the situation where one acts under doubt and pressure, whereas the instruction given by Judge Hill states that there must be a willingness. The willingness of Judge Hill's instruction negates the coercion of the D. C. Circuit.

In any event, while the instruction given here is different than those given in Jones and McGill, even those used in Jones and McGill did not result in reversals. The question here is whether there has been any prejudice as a result of the instruction given. It is submitted that there has been none, and the instant issue is a furor without a problem. Perhaps the language of McGill, at 797, is appropriate:

> " . . . The standard of mental convincement

of a jury may only be approached with words groping to express what is nearly indefinable. Some day perhaps the relevant concepts may be given a quantitative reference, perhaps in terms of probability but meanwhile, we must communicate with words, limited though they may be, for the judge to impress upon a jury the awesome task that is theirs." (Footnotes omitted)

Certainly the statement to Judge Hill that his intended instruction had been held to be error was not, and is not, the case.

VI

CONCLUSION

For the above-stated reasons the judgment of the District Court should be affirmed.

Respectfully submitted,

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No. 22,515

...ited States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

v.

RETAIL CLERKS INTERNATIONAL ASSOCIATION, LOCAL UNION NO. 899, AFL-CIO; AMALGAMATED MEAT CUTTERS AND BUTCHER WORKMEN OF NORTH AMERICA, LOCAL UNION NO. 556, AFL-CIO; INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, LOCAL UNION NO. 381; INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, JOINT COUNCIL OF TEAMSTERS NO. 42, AND SAN LUIS OBISPO BUILDING AND CONSTRUCTION TRADES COUNCIL, AFL-CIO,

Respondents.

On Petition for Enforcement of An Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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On Petition for Enforcement of An Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon the petition of the National Labor Relations Board, pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 51, *et seq.*),[1] for enforce-

[1] The pertinent statutory provisions are set forth in Appendix B, *infra.*

136, 73 Stat. 519, 29 U.S.C. Sec. 151, *et seq.*),[1] for enforcement of its order (R. 71;33)[2] issued against the respondents on July 23, 1967, and reported at 166 NLRB No. 92. This Court has jurisdiction of the proceeding under Section 10(e), the unfair labor practices having occurred at Arroyo Grande and San Luis Obispo, California.

STATEMENT OF THE CASE

I. THE BOARD'S FINDINGS OF FACT

Briefly, the Board found that the respondent Unions violated Section 8(b)(7)(C) of the Act by picketing the Company stores for more than thirty days without the filing of an election petition and with a proscribed recognitional objective. The evidence upon which the Board based its findings is as follows:

A. The picketing of the Company stores

State Mart, Inc., hereinafter referred to as the Company, is engaged in the operation of two retail food stores in Southern California, one in Arroyo Grande and the other in San Luis Obispo (R. 34; Tr. 67). At no time pertinent to the issues involved herein were the employees at either store represented by a labor organization (R. 35). No election has ever been held to determine the employees' choice in regard to unionism; nor has any labor organization sought to obtain such an election (*Ibid.*).

Since its opening in September of 1961, the Arroyo Grande store has been picketed by representatives of respondent Retail Clerks (R. 35; Tr. 120).[3] Originally, the pickets

[2] References designated "R." are to Volume I of the record as reproduced pursuant to rule 10 of this Court. "Tr." references are to the reporter's transcript of testimony as reproduced in Volume II of the record. References to the General Counsel's exhibits are designated "G.C. Exh."

[3] Retail Clerks International Ass'n., Local Union No. 899.

carried signs advertising the fact that the Company had no contract with the Retail Clerks, but by June of 1963, at which time the respondent Meatcutters[4] began to take part in the picketing, the signs had been altered to indicate only that the Company failed to meet the wages and working conditions provided by organized employers in the area (R. 35; Tr. 127-128, 136). On November 2, 1965, when the San Luis Obispo store opened, the two Unions immediately established picket lines at that location and, thereafter, continued the picketing at both stores with signs reading as follows (R. 35; Tr. 74):

> This market unfair because they do not pay the prevailing wage rates or benefits paid by other markets in the area. Members of Retail Clerks Local 899 and Meatcutters Local 556, AFL-CIO, protest the substandard wage rates paid in this market. (R. 35; Tr. 96, 127-128).

Shortly after the opening of the San Luis Obispo store, the respondent Building Trades Council[5] began to take part in the picketing, displaying signs declaring that "the San Luis Obispo Building Trades Council supports the Retail Clerks and the Meatcutters Unions" (R. 35; Tr. 75, 96, 121, 127-128). Then, on January 21, 1966, the three picketing Unions were joined by respondent Teamsters Local and respondent Teamsters Joint Council,[6] whose representative on the picket line carried a sign with the following legend: "This picket line sanctioned by Teamsters Local 381 and Joint Council of Teamsters 42" (R. 35; Tr. 75, 96, 122, 127-128). Since the appearance of the Teamster picket, regular deliveries by suppliers of both stores have ceased altogether (R. 35-36; Tr. 13, 92). Consequently, the Company has been forced to use

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[4] Amalgamated Meatcutters and Butcher Workmen, Local Union No. 856.

[5] San Luis Obispo Building Trades Council.

[6] International Brotherhood of Teamsters, Local Union No. 381 and Joint Council of Teamsters No. 41.

its own trucks and labor to pick up goods directly from the various suppliers (R. 35-36; Tr. 94).

B. The Union's definition of area standards: The February 1 meeting

On January 27, 1966, about a week after the deliveries had stopped, a Company representative telephoned Kenneth Schwartz, counsel for the Retail Clerks, in order to find out what could be done to bring about the removal of the picket lines (R. 36; Tr. 13-14, 149). In response to this inquiry, Schwartz stated that the picket lines would be lifted only if the Company would adhere to the wages and working conditions prevailing in the area (*Ibid.*). Rather than pursue the matter further over the telephone, the Union and Company representatives agreed to meet at some future date for the purpose of defining the precise nature of the "area standards" (*Ibid.*).

The meeting took place on February 2, 1966, at San Luis Obispo (R. 37; Tr. 15, 151).[7] At the outset, Kenneth Schwartz, acting as spokesman for the Retail Clerks and Meatcutters, asserted that the meeting was being held solely to advise the Company "what we meant by standards in this particular area" and that the Unions did not intend either to "ask for an organization" or to "negotiate an agreement" (R. 37; Tr. 152). Then, Schwartz proceeded to set forth the Unions' definition of area standards, declaring that such standards encompassed not only wages but also "fringe benefits" and "other benefits," including health and welfare plans, pensions and vacations (R. 37; Tr. 153). The central theme of the meeting was that adherence to area standards would necessitate the payment to Company employees of "the same benefits" as were received by organized employees in the area (R. 37; Tr. 153, 17, 27). The cost of these benefits would be immaterial; the Union's only concern was with

[7] Only the respondent Retail Clerks and Meatcutters were actually represented at the meeting (R. 45; Tr. 15).

"getting these benefits for the employees and the cost was in the province of the employer" (*Ibid.*). Moreover, when wages and benefits in the area were altered, the Company would be expected to change its rates accordingly (Tr. 18-20). As Schwartz expressly asserted, "[the Company] was to maintain the standards in the area, whatever the standards would be, and for whatever time the standards were in effect" (Tr. 177).

After this general statement of the Union demands, the discussion shifted to the precise nature of various contract benefits and, at this point, the Union representatives produced copies of the area bargaining agreements (R. 37; Tr. 20, 156-158). Before actually presenting these contracts to the Company, the Unions undertook to strike out certain clauses which would not bear upon the question of area standards (R. 37-38; Tr. 158-160). In both the Retail Clerks and the Meatcutters contracts, the deleted portions related almost exclusively to Union security, hiring procedures and recognition (*Ibid.*). The portions left intact included articles concerning wage rates, fringe benefits, discharge procedures, seniority rights, working hours, overtime, grievance procedures and arbitration (*Ibid.*). When the deletion process was completed, the Unions submitted the altered documents to the Company with the representation that, except for those portions physically stricken, the contracts set forth the benefits that organized employees were receiving and that the Company must provide for its employees in order to comply with "area standards" (R. 38; Tr. 20, 41, 52). Schwartz further stated that, in presenting the contracts, he did not "want it to be construed that [he was] making any demands but [he wanted the Company] to know the type of benefits the employees enjoy under our agreement, to explain the area standards" (R. 37; Tr. 158).

The ensuing discussion of specific contract provisions centered principally on such fringe benefits as health, welfare and pensions (R. 39; Tr. 154). Under the two Union contracts, these benefits were administered through area-wide trust funds to which the individual employers contributed

(*Ibid.*). The Retail Clerks and Meatcutters trusts covered 20,000 and 10,000 employees, respectively (R. 39; Tr. 233, 180). Union representatives insisted that the Company must pay its employees the identical welfare benefits "in dollars and cents and over a period of time," as received by these represented employees [Tr. 169]. However, Schwartz made it clear that the Company would not be allowed to participate in the trust funds administered by the Unions because "the only ones who could contribute to these trusts would be signatories to the collective bargaining agreement" (R. 39; Tr. 155). Acknowledging that, without participation in those trusts "these benefits would cost [the Company] more" because of the difference in the size of the groups and might even be an "insurmountable" cost (R. 37; Tr. 17, 26, 65, 166), Schwartz disclaimed any interest in the cost of the benefits, informing the Company representatives that they "would have to work this out through [their] brokers, for health, welfare and pensions, etc" (Tr. 168-169). Union representative Schwartz also told Company representative Frame that "if his employer could give these employees these benefits at half the cost, that is his privilege" (Tr. 165). When the Company representatives inquired as to the possibility of modifying certain of the contract benefits, the Unions consistently maintained that the meeting was not a negotiating session, that none of the benefits were subject to negotiation and that the contracts spoke for themselves in regard to the definition of the benefits (R. 39; Tr. 18, 173).

At the conclusion of the meeting, the Company representatives stated that they would be unable to make an immediate decision in regard to the Union demands and picketing continued.

II. THE BOARD'S CONCLUSION AND ORDER

Upon the foregoing facts, the Board found that the respondent Unions had violated Section 8(b)(7)(C) of the Act by picketing the Company stores for more than thirty days without the filing of an election petition and with a

proscribed recognitional objective. The Board issued an order requiring all respondent Unions to cease and desist from the unfair labor practices found and to post the appropriate notices (R.71;33).

ARGUMENT

THE BOARD PROPERLY FOUND THAT THE RESPONDENT UNIONS HAD A PROSCRIBED RECOGNITIONAL OBJECTIVE AND THAT THEIR PICKETING WAS VIOLATIVE OF SECTION 8(b)(7)(C) OF THE ACT

A. Introduction: Section 8(b)(7)(C) of the Act

Section 8(b)(7), enacted as part of the 1959 amendments to the Act, constitutes a comprehensive code governing recognitional and organizational picketing. *N.L.R.B. v. Drivers, Local 639 (Curtis Bros.),* 362 U. S. 274, 291. Subsection (C) of Section 8(b)(7), which is involved herein, prohibits picketing by an uncertified union where an object thereof is "forcing or requiring an employer to recognize or bargain with a labor organization as the representative of his employees," if such picketing has been conducted for more than thirty days without the filing of an election petition. A proviso to this subsection exempts from the prohibition "any picketing or other publicity for the purpose of truthfully advising the public (including consumers) that an employer does not employ a member of, or have a contract with a labor organization" unless an effect of such picketing is to induce employees of other employers not to pick up or deliver goods.

As the Board, the courts and the commentators have repeatedly pointed out, Section 8(b)(7) was enacted as a corollary to the federal policy of ensuring employees a free choice in the selection of a bargaining representative. *Dayton Typographical Union No. 57 v. N.L.R.B.,* 326 F.2d 634-637 (C.A.D.C.); *Local 542, Operating Engineers (R. S. Noonan,*

Inc.), 142 NLRB 1132, enf'd., 331 F.2d 99, 107 (C.A. 3), cert. denied, 379 U. S. 889; *Lebus v. Building and Construction Trades Council of New Orleans,* 199 F. Supp. 628, 631-632 (E. D. La.); Cox, *The Landrum-Griffin Amendments to the NLRA,* 44 Minn. L. Rev. 257, 262-266 (1959); Meltzer, *Organizational Picketing and the NLRA,* 30 U. of Chi. L. Rev. 78, 79-80, 83 (1962). Prior to the enactment of the 1959 amendments, a union could lawfully picket an unorganized employer for an unlimited length of time, either to compel the employer to recognize it as the bargaining representative of his employees or to force or require the employees to select it as their representative. Section 8(b)(7)(C) removes this threat to employee free choice by encouraging prompt resort to the Board's election machinery, rather than the economic pressures of picketing, as the method for resolving questions of representation.

In the case at bar, neither the respondent Retail Clerks nor respondent Meatcutters has ever been certified as a representative of the Company employees and it is undisputed that the picketing has been carried on for more than thirty days without the filing of an election petition. Furthermore, since deliveries to both Company stores were all but totally stopped as a direct result of the picketing, no claim is made that the proviso to Section 8(b)(7)(C) has any applicability (R. 36; Tr. 13, 92). See *Barker Bros. Corp. v. N.L.R.B.,* 328 F.2d 431 (C.A. 9); *N.L.R.B. v. Local 542, Operating Engineers,* 331 F.2d 99 (C.A. 3). Thus, the sole issue before

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[8] The Board had held that recognitional picketing by a minority union was a Section 8(b) (1) violation, arguing that such picketing interfered with the employees' Section 7 rights to refrain from union activities. However, this argument was rejected by the Supreme Court. *N.L.R.B. v. Drivers, Local 639, supra.* Consequently, the only restriction on recognitional picketing was embodied in Section 8(b)(4)(C), which prohibited picketing for an object of recognition where a union was already certified as the bargaining representative of the employees. This provision had no application where employees were unrepresented or where a union was recognized without a Board election and hence not certified.

the Court is whether the Board properly found that the respondent Unions had a recognitional objective when it picketed the Company's stores.

B. Respondents' object was recognitional and not limited to preservation of area standards

1. Introduction

When a union pickets an employer for the sole purpose of compelling compliance with prevailing area wage and benefit standards, the Board regards the picketing activity — so-called "area standards" picketing — as non-recognitional and outside the prohibition of Section 8(b)(7). See, *e.g., Houston Building and Construction Trades Council (Claude Everett Construction Co.),* 136 NLRB 321; *Local Union 71, Plumbers Union (Keith Riggs Plumbing and Heating Contractor),* 137 NLRB 1125; *Local 107, Hod Carriers Union (Texarkana Construction Co.),* 138 NLRB 102. In the instant case, the respondent Unions have consistently described their picketing as motivated solely by such a permissible area standards object. Undeniably, the formal declarations of Union representatives and the legends of the picket signs were entirely consistent with this purported objective. Moreover, no direct demands for representative status were ever made and, in fact, on several occasions, the Unions expressly disclaimed all recognitional ambitions.

However, in determining whether a union has picketed for a proscribed object, the Board is not bound by a union's self-serving description of its own objective. *N.L.R.B. v. Local 182, International Brotherhood of Teamsters,* 314 F.2d 53, 58 (C.A. 2); *Penello v. Retail Store Employees, Local 692,* 188 F. Supp. 192, 201 (D. Md.). When actual conduct beflects an underlying or accompanying recognitional object, the Board discounts claims that the union is engaged solely in area standards picketing. *Centralia Building and Construction Trades Council v. N.L.R.B.,* 363 F.2d 699 (C.A.D.C.); *N.L.R.B. v. Carpenters, Local 2133,* 356 F.2d 464, 465-466 (C.A. 9); *N.L.R.B. v. Building and Construction Trades Council of Philadelphia,* 359 F.2d 62, 63 (C.A. 3); *Operative Plasterers*

Union, Local 44 (Penny Construction Co.). 144 NLRB 1298.[9] We show below that the demands set forth by the Unions as pre-conditions to removal of the picket lines, although couche in terms of area standards, went well beyond a legitimate unio concern for maintaining area standards and were tantamount t a request for recognition.

2. Respondents exceeded the limited objective of true area standards picketing

Under Section 8(b)(4)(C), which preceded Section 8(b)(7) as a legislative limitation on recognitional picketing, see, *supra*, p. 8, n. 8, the Board took the position that any picketing in support of demands that could be made through the process of collective bargaining amounted to picketing for recognition. See *Hod Carriers, Local 741 (Calumet Contractors Ass'n),* 130 NLRB 78, 81-82; *Hod Carriers Union, Local 840 (C.A. Blinne Construction Co.),* 135 NLRB 1153, 1165, n. 29; *Lewis Food Co.,* 115 NLRB 890. Applying this doctrine, the Board consistently held area standards picketing to be violative of the Act. *Petrie's,* 108 NLRB 1318; *Francis Plating Co.,* 109 NLRB 35; *Carter Mfg. Co.,* 120 NLRB 1609; *District Lodge No. 24, International Ass'n of Machinists,* 121 NLRB 1298.

Upon reconsideration of this position, however, the Board reversed its previous position and held that picketing "to conform standards of employment to those prevailing in the area is not tantamount to, nor does it have an object of recognition or bargaining." *Calumet Contractors Association,* 133 NLRB 512. The Board reasoned that (133 NLRB at 512-513):

[9] In order to establish a violation of Section 8(b)(7), it is not necessary that recognition be the sole object of the picketing; it is sufficient if an object is recognition. *Smitley v. N.L.R.B.*, 327 F.2d 351 (C.A. 9); *N.L.R.B. v. Building and Construction Trades Council of Phila., supra,* at 63; *Dayton Typographical Union No. 57 v. N.L.R.B.*, 326 F.2d 634 (C.A.D.C.).

> A union may legitimately be concerned that a particular employer is undermining area standards of employment by maintaining lower standards. It may be willing to forego recognition and bargaining provided subnormal conditions are eliminated from area considerations . . . . As this object may be achieved without the employer either bargaining with or recognizing the [Union], we cannot reasonably conclude that [the union's] object was to obtain recognition.[10]

Subsequently, when the same issue arose under the 1959 amendments, the Board applied the *Calumet* rationale where area standards picketing was alleged to be in violation of Section 8(b)(7). *Houston Building and Construction Trades Council (Claude Everett Construction Co.),* 136 NLRB 321. In *Local 741, Plumbers Union (Keith Riggs Plumbing),* 137 NLRB 1125, 1126, the Board further explicated the limited, non-recognitional objective of area standards picketing:

> A labor union normally seeks to organize the unorganized and to negotiate collective bargaining contracts; but, it also has a legitimate interest apart from recognition and bargaining that employers meet prevailing pay scales and employee benefits, for otherwise employers paying less than the prevailing wage scales could ultimately undermine area standards.

In short, the non-recognitional concern underlying area standards picketing is the fear that unorganized employers, operating with lower labor costs, will undersell unionized competitors, thereby forcing the organized employers to

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[10] The second *Calumet* opinion was one of a series of decisions in which the Board overruled its earlier view of area standards picketing and held, in effect, that a union might lawfully picket for objects normally achieved through collective bargaining, if the immediate object of the picketing was not recognition. See *Fanelli Ford Sales, Inc.,* 133 NLRB 1468; *Mission Valley Inn,* 140 NLRB 433; *Hod Carriers Local 840 (Blinne Construction Co.),* 135 NLRB 1153.

press the union for a downward modification of the negotiated contract rates. In *Calumet* and in the succeeding decisions under Section 8(b)(7), the Board recognized this "legitimate interest apart from recognition and bargaining." *Keith Riggs Plumbing Co., supra,* at 1125-1126, and excepted area standards picketing from the prohibition of Section 8(b)(7).

However, since the threat to union standards is created by unorganized employers who pay less for labor, true area standards picketing seeks only the elimination of this condition. So long as the unorganized cmployer's labor costs equal those of his organized competitor, there is no danger that union standards will be undermined. We show below that respondents' demands were not limited to the elimination of differences in labor costs and thus did not directly relate to the preservation of economic gains already achieved for its members.[11]

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[11] We anticipate that respondents will renew the contention that the Board has previously held that picketing aimed at requiring unorganized employers to adopt the specific benefits contained in area contracts was permissible area standards picketing. The argument was based upon language taken out of context from the *Keith Riggs* decision. Thus, although respondents relied upon so much of that opinion as stated that a labor organization has "a legitimate interest apart from recognition or bargaining that employers meet prevailing wage scales and employee benefits," 137 NLRB at 1126, they overlooked the next clause of the very same sentence — "for otherwise employers paying less than the prevailing wage scales could ultimately undermine area standards." *Ibid.* The Board clearly indicated that the distinctly non-recognitional objective involved was preventing the undermining of existing union standards.

The commentators have recognized a distinction between area standards picketing and recognitional picketing and have consistently characterized area standards picketing as purely defensive. Professors Cox and Aaron would allow such picketing only where the union can affirmatively prove that "the labor standards of which [it] complains are *such a substantial threat to existing standards* as to support a finding that the union has a genuine interest in compelling

(Continued)

It is undisputed that respondent Unions demanded, as a precondition to removal of the picket lines, that the Company provide for its employees "the same" wages and fringe benefits, including identical health, welfare and pension plans, as were embodied in the area bargaining contracts (R. 37; Tr. 17, 27, 153). They were admittedly not concerned solely with the cost to the Company of providing the required benefits and would not have lifted the picket lines in return for a promise to meet the labor costs of the companies organized by respondents.[12] On the contrary, the Unions sought, not simply to raise Company costs to Union scale, but also to dictate the manner in which labor costs would be distributed to Company employees. Thus, the Unions sought to establish specific wage rates, and specific health, welfare and pension plans with fixed amounts which the employees would receive under each of the plans.

Such control over the terms and conditions of employment of unorganized employees was clearly beyond respondents' area standards interest. Once the Company's competitive advantage had been eliminated and the rights of currently organized employees thereby secured, the Union's further demands were focused solely upon the interests of the Company employees. In effect, the Unions were seeking to gain a specific allocation of benefits for employees who had not designated them as bargaining representative. The Company's employees might well have preferred that an economic package designed to impose equal costs on the Company be distributed wholly in the form of increased wages. But, in any

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(Continued from preceding page)

the improvement of labor conditions or eliminating the competition" (emphasis supplied). Cox, *supra,* at 267; Aaron, *The LMRDA of 1959,* 73 Harv. L. Rev. 1086, 1104-1105 (1960). See also, Weis, *The Unlawful Object in Section 8(b)(7) Picketing,* 13 Lab. L. J. 787, 794 (1962); Comment, *Picketing by an Uncertified Union,* 69 Yale L. J. 1393, 1399-1400 (1960); Dunau, *Some Aspects of the Current Interpretation of Section 8(b)(7)* 52 Geo. L. J. 220, 227-230 (1964).

[12] Indeed, as noted in the Statement, *supra,* p. 6, Union representative Schwartz went so far as to say that respondents did not care whether the Company could provide the same benefits at less cost — an admission difficult to reconcile with an area standards objective.

event, this was a decision that should be made by the Company and its employees themselves, in the absence of a freely elected bargaining agent. When the respondents demanded the right to make this decision, they were, *pro tanto*, demanding recognition. Since the Unions picketed in support of their demands, the Board correctly found that the picketing was for the object regulated by Section 8(b)(7).[13]

Meat and Highway Drivers, Local 710 v. N.L.R.B., 335 F.2d 709 (C.A.D.C.), which involved the application of Section 8(e) of the Act, provides substantial support for the Board's conclusion.[14] There, the Court considered the legality of a clause in a collective bargaining agreement which provided that the employer could subcontract delivery work only to cartage companies "whose truck drivers enjoy the same or greater wages and other benefits as provided in this agreement for making of such deliveries." *Ibid.*, at 715.

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[13] The fact the Unions did not seek to obtain a written contract, binding the Company to a long-term relationship, does not detract from the finding of a recognitional object. "The statute refers to bargaining — not to bargaining for any period of time." *National Packing Co. v. N.L.R.B.*, 377 F.2d 800, 803-804 (C.A. 10). Similarly, it is of no importance that the Unions did not attempt to negotiate an overall bargaining contract. Union demands need not cover the whole range of bargaining subjects in order to amount to recognition. *Dallas Bldg. & Constr. Trades Council v. N.L.R.B.*, ___ F.2d ___ (C.A.D.C.), No. 21,057, decided April 23, 1968, 68 LRRM 2019, ___; *National Packing Co. v. N.L.R.B., supra*, at 804; *Centralia Building and Construction Trades Council v. N.L.R.B.*, 363 F.2d 699, 701 (C.A.D.C.).

[14] Section 8(e) provides, in relevant part: "It shall be an unfair labor practice for any labor organization and any employer to enter into any contract or agreement . . . whereby such employer . . . agrees . . . to cease doing business with any other person."

Generally speaking, the Section is applicable where a contract clause is aimed at affecting the labor relations of another employer but not applicable where the aim is to protect the work of the employees of the contracting employer. See *Nat'l Woodwork Mfrs. Ass'n v. N.L.R.B.*, 386 U. S. 612.

Initially, the Court noted the general rule that subcontracting clauses are valid if they require only that subcontractors maintain union standards, but invalid if they require that subcontractors be signatories to union contracts. *Ibid.*, at 715, n. 16. While clauses in the former category merely protect the negotiated conditions of employment of the primary employer, by eliminating the incentive to contracting out bargaining unit work to subcontractors with lower labor costs, clauses of the latter type seek to impose unionism on unorganized employers and employees. Concluding that the clause before it fell in the former category, the Court upheld the validity of the contract. However, in doing so, the Court added the following qualification (*Id.*, at 715, m.1S):

> We take it that the phrase 'same or greater wages and benefits' in the [contract clause] requires only that the total cost to the employer be the same or greater. Thus, the temptation of cheap labor is removed without requiring details identical with the Union contracts.

Here, although we are not concerned with Section 8(e), the analysis is similar. Had respondents limited their demands to requiring that "the total cost" of labor to State Mart "be the same or greater" than the cost to unionized competitors, it could reasonably be said that respondents were concerned only with removing the threat to union standards by eliminating "the temptation of cheap labor." However, by "requiring details identical with the union contracts," respondents betrayed what can only be classified as a recognitional object.

3. <u>The conduct of the Union representatives reveals a recognitional object</u>

We submit that where a union is not content with equalizing labor costs but requires adoption of details identical with union contracts, a recognitional objective is established, and no further showing need be made. However, in the instant

case respondents' conduct at the February 1 meeting further buttresses the Board's conclusion that they sought recognition.

At this meeting, Union representatives repeatedly asserted that the sole aim of the picketing was to enforce compliance with area standards and that these area standards were embodied in the union bargaining contracts. Then, when the contracts were presented to the Company's representatives, ostensibly to familiarize them with "the area standards" (R. 37; Tr. 153, 158), virtually the only items which the Unions struck out as inapplicable were clauses relating to recognition and union security. Left intact were detailed contract provisions concerning arbitration, grievance procedures, discharge, hours, overtime, seniority, and other non-cost items ordinarily associated with an established collective bargaining relationship. While the chief Union spokesman now testifies that he was not attempting to strike out all clauses which were not to be applicable to the Company, this fact was not communicated at the meeting and, indeed, no affirmative effort was ever made to make it clear to the Company that adherence to them was not required as the price for removing the pickets. The Unions' insistence that the Company assent to such contract provisions as arbitration and seniority cannot be ~~reconcile~~ reconciled with its declared area standards objective. These non-cost items do not contribute to the unorganized employer's competitive advantage and cannot be deemed to pose a threat to already existing standards. Accordingly, the thrust of the Union demands went beyond protection of area standards and, in fact, amounted to a request that the respondents assume the role of bargaining representative for the Company employees (albeit, the bargaining would be done with other employers) in regard to virtually all terms and conditions of employment.

The Unions' position in regard to the industry-wide trust funds presents an additional indication of the recognitional object underlying the picketing activities. At the February 1 meeting, the Union representatives admitted that, without access to the trust funds, the burden of providing equivalent benefits for the considerably smaller

Company group would be much higher.[15] Yet, the Unions still demanded that the Company provide such equivalent benefits, while simultaneously declaring that only signatories to union contracts could take part in the trust fund program. Obviously, a demand of this type, which places a greater cost burden on the unorganized employer than is borne by organized employers, cannot be justified as protection of area standards. Furthermore, when a union knowingly puts forth a demand which, although unrelated to labor costs, will create real economic hardship for the employer, making it clear that the hardship can be effectively alleviated only by signing a Union contract, the reasonable inference is that disclaimers of recognitional intent are no more than attempts to mask the true object of attaining representative status.[16]

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[15] Company representatives testified that the Union representatives present at the meeting conceded that the cost would be "astronomical" and "insurmountable" (R.37; Tr. 17, 26). The Union representatives denied using these words, but admitted knowledge that the cost to the Company would be greater (Tr. 166). This difference in testimony is irrelevant for present purposes.

[16] As Professor Cox has pointed out, Section 8(b)(7) should not apply to picketing which seeks "to prevent the distribution of the low cost, non-union goods in direct competition with the products of union labor." Cox, *supra,* 44 Minn. L. Rev. at 266. However, he recognizes the danger in this limited exclusion (*Id.,* at 267):

> "The union's objective of eliminating the competition based upon differences in labor standards can be accomplished without interfering with the [employees'] decision concerning union representation. The danger in distinguishing picketing to protest substandard wages or working conditions from picketing for union recognition or organization is that it may encourage verbal evasions through disingenuous phrasing of the pickets' placards and the union's demands."

C. The Board's order was properly directed against all respondent Unions

The demands discussed above were put forth solely by the Meatcutters and Retail Clerks. However, the other respondent Unions, by placing their representatives on the picket line, put their full weight behind those demands and, in effect, became parties to a joint venture aimed at accomplishing the objectives of the two active Unions. *N.L.R.B. v. District Council of Carpenters,* 387 F. 2d 170 (C.A. 2), *Retail Clerks, Local 324 (Barker Bros. Corp.),* 138 NLRB 478, 485-486, enf'd, 328 F.2d 431 (C.A. 9); *Shore v. Building Trades Council of Pitts.,* 173 F.2d 678, 682 (C.A. 3); *Cf. Schauffler v. Highway Truckdriver and Helpers, Local 107,* 230 F.2d 7, 10-11 (C.A. 2). As these objectives were recognitional in nature, respondents Teamsters Local, Teamsters Joint Council and Building Trades Council must be held to have violated Section 8(b)(7)(C). Indeed, since the serious injury to the Company stores — the stoppage of deliveries — did not even begin until the respondent Teamsters Local and Teamsters Joint Council appeared on the picket line, an order which issued only against the Meatcutters and Retail Clerks would be futile, leaving the other Unions free to continue effective picketing in support of the recognitional objectives of the Meatcutters and the Retail Clerks.

CONCLUSION

For the reasons stated, the Board's order should be enforced in full.

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May, 1968

CERTIFICATE OF SERVICE

The undersigned certifies that he has examined the provisions of rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST
Assistant General Counsel
NATIONAL LABOR RELATIONS BOARD

APPENDIX A

Pursuant to rule 18(2)(F) of the Rules of this Court:

Exhibits in the instant case. (Page references are to the numbered pages of the transcript).

GENERAL COUNSEL'S EXHIBITS

No.	Identified	Offered	Received in Evidence
1(a) through 1(j)	6-7	6-7	7
2 and 3	21	23	24
4	23	23	24
5	113-114	115	115
6	139	140	141
7	139	142	142
8	139	143	143

RESPONDENT RETAIL CLERKS' EXHIBITS

No.	Identified	Offered	Received in Evidence
1 and 2	30	58	58

RESPONDENT MEATCUTTERS' EXHIBITS

No.	Identified	Offered	Received in Evidence
1	219	221	222

APPENDIX B

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*) are as follows:

(b) It shall be an unfair labor practice for a labor organization or its agents –

* * *

> (4) (i) to engage in, or to induce or encourage any individual employed by any person engaged in commerce or in an industry affecting commerce to engage in, a strike or a refusal in the course of his employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services; or (ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where in either case an object thereof is: (C) forcing or requiring any employer to recognize or bargain with a particular labor organization as the representative of his employees if another labor organization has been certified as the representative of such employees under the provisions of section 9;

* * *

> (7) to picket or cause to be picketed, or threaten to picket or cause to be picketed, any employer where an object thereof is forcing or requiring an employer to recognize or bargain with a labor organization as the representative of his employees, or forcing or requiring the employees of an employer to accept or select such labor organization as their collective bargaining representative, unless such labor organization is currently certified as the representative of such employees: . . . (C) where such picketing has been conducted without a petition under section 9(c)

being filed within a reasonable period of time not to exceed thirty days from the commencement of such picketing: . . . *Provided Further,* that nothing in this subparagraph (C) shall be construed to prohibit any picketing or other publicity for the purpose of truthfully advising the public (including consumer) that an employer does not employ members of, or have a contract with, a labor organization, unless an effect of such picketing is to induce any individual employed by any other person in the course of his employment, not to pick up, deliver, or transport any goods or not to perform any services. Nothing in this paragraph (7) shall be construed to permit any act which would otherwise be an unfair labor practice under this Section 8(b).

No. 22,515

United States Court of Appeals

For the Ninth Circuit

National Labor Relations Board,

Petitioner,

vs.

Retail Clerks International Association, Local Union No. 899, AFL-CIO; Amalgamated Meat Cutters and Butcher Workmen of North America, Local Union No. 556, AFL-CIO; International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, Local Union No. 381, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, Joint Council of Teamsters No. 42; and San Luis Obispo Building and Construction Trades Council, AFL-CIO,

Respondents.

INTERVENOR'S BRIEF

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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Respondents.

INTERVENOR'S BRIEF

JURISDICTIONAL STATEMENT

This is a petition by the National Labor Relations Board (hereinafter called the Board) to enforce its Decision and Order (*State-Mart, Inc., d/b/a Giant Food,* 166 NLRB No. 92). This Court has jurisdiction by virtue of Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 29 U. S. C.,

Secs. 151 et seq., as amended by 73 Stat. 519), hereinafter called the Act.

Intervenor, State-Mart, Inc., was the successful charging party in the proceedings before the Board.

Respondents have filed counter-petitions asking that enforcement be denied.

STATEMENT OF THE CASE

Intervenor operates two retail markets. One is in Arroyo Grande, California. The other is in San Luis Obispo, California. The two stores are approximately 13 miles apart. Both stores sell a general line of groceries, meats and produce.

The Arroyo Grande store opened in September, 1961. The San Luis Obispo store opened on November 2, 1965.

The Arroyo Grande store has been picketed since it opened. However, until the San Luis Obispo store opened the pickets at Arroyo Grande were few in number and there was no interference with deliveries.

Pickets also appeared at the San Luis Obispo store when it opened. There were as many as 70 at one time. (Tr. 90).[1] Coincidentally there was a substantial increase in the number of pickets at the Arroyo Grande store. (Tr. 135).

After the San Luis Obispo store opened the pickets at both stores interfered with the ingress and egress of patrons. (Tr. 90, 91, 97, 102, 123, 124, 135). Pickets

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[1]Numbers in parentheses refer to the Reporter's Transcript.

shouted obscenities at patrons and employees, photographed automobiles entering the premises and recorded license numbers. (Tr. 100-101, 123-124, 126-127, 130). The San Luis Obispo store was picketed 24 hours per day. The store was open 12 hours per day. (Tr. 91). Pickets appeared at the Arroyo Grande store at 6:00 a.m. The store opened at 9:00 a.m. (Tr. 125).

On January 19, 1966, Intervenor obtained an injunction in a state court limiting the number of pickets at the San Luis Obispo store. By agreement the restrictions imposed by the state court were observed also at the Arroyo Grande store.

Until this point the picketing had been carried on by Respondent Retail Clerks and Respondent Meat Cutters. They had been joined in December, 1965, by Respondent Building Trades Council.

Despite the mass picketing and accompanying conduct there was not at this point any substantial interference with deliveries of merchandise.

On January 20, 1966, Respondent Teamsters and Respondent Teamsters Joint Council joined the picketing at both stores. After that date all or almost all deliveries of merchandise stopped. (Tr. 94, 125).

There is evidence that deliveries were stopped by pickets jumping in front of the trucks and jumping on their running boards. (Tr. 94). There is also evidence that pickets followed the manager of the San Luis Obispo store during trips by him from the store to pick up merchandise for the store elsewhere. On

at least two occasions pickets followed the manager onto premises of neutral employers. (Tr. 145-147).

On or about January 27, 1966, Ted Frame, Intervenor's counsel, telephoned Kenneth Schwartz, counsel for Respondent Retail Clerks, to see what could be done to remove the pickets. Schwartz told Frame that Respondents would remove the pickets if Intervenor met the "area standards". (Tr. 13, 150). Schwartz did not want to discuss on the telephone what the "area standards" were. A meeting was arranged to discuss the matter further. It took place at San Luis Obispo on February 1, 1966.

The meeting at San Luis Obispo was attended by representatives of Intervenor and of Respondents. Frame acted as spokesman for Intervenor. Schwartz acted as the principal spokesman for Respondents.

Respondents defined "area standards" as the identical employment terms and benefits provided for in collective bargaining agreements with other market owners within Respondents' jurisdiction. (Tr. 153, 236-237).

Intervenor was told that the cost of its meeting such "standards" was immaterial. (Tr. 153).

As the "standards" changed from time to time (due to negotiated changes in collective bargaining agreements with other market owners), Intervenor was to change its employment terms and benefits accordingly. (Tr. 65, 177).

During the meeting Respondents handed Intervenor copies of Respondent Clerks' and Respondent

Meat Cutters' area-wide industry agreements. (G. C. Exhs. 2 and 3). Respondents did so to show Intervenor what the "standards" were. (Tr. 173). Respondents also handed Intervenor a pamphlet entitled "Industry Vacation Plan" (G. C. Exh. 4).

Before handing Intervenor the industry agreements, Respondents struck out the union recognition and union shop clauses. However, clauses relating to discharge procedures, seniority, times of store meetings so as not to conflict with union meetings, visits of union representatives to the stores, discharge of expelled union members, grievances and arbitration, health and welfare benefits and trust funds, and pension provisions and trust funds, were not stricken.[2]

The industry agreements provide *inter alia* for "portability" of pension benefits.[3]

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[2]A more complete tabulation appears in footnote "3", page 6, of Trial Examiner Penfield's decision dated January 12, 1967.

[3]The Retail Clerks' industry agreement (G. C. Exh. No. 2) refers on page 23 to the Southern California Retail Clerks Unions and Food Employers joint Pension Trust Fund (G. C. Exh. No. 6). All retail clerks working in Southern California for any employer who has a collective bargaining agreement with Local 137, 324, 770, 899, 905, 1167, 1222, 1428 or 1442 are covered. (See G. C. Exh. No. 6, P. 1, Article I, Declaration of Trust, and p. 1, Article I, Joint Pension Plan). If a member goes to work for an employer who is not a signatory to a collective bargaining agreement, his Continuous Service is broken after 12 months and he loses his previous credits to his pension benefit unless he had a vested pension (10 years Credit Service). (G. C. Exh. No. 6, p. 4, Article VI, Joint Pension Plan).

Portability is provided for in Article I, Sections 1, 2, and 3, of the Declaration of Trust which begins on page 30 of the Meat Cutters industry agreement (G. C. Exh. No. 3) and in the September 29, 1958, amendment which appears on page 39 of the industry agreement.

"Portability" means that if an employee builds up credits while working for an employer, he does not lose those credits if he takes a job with another employer, *so long as* both employers are signatories to the industry agreement. (Tr. 233, line 15, to 234, line 8; 237, lines 11-12).

Intervenor was not willing to meet Respondent's demands. The picketing continued.

Following a timely charge filed by Intervenor, the Board's Regional Director issued a complaint which alleged that the picketing, without an election petition, was for a recognitional or organizational purpose in violation of section 8(b) (7) of the Act. The Trial Examiner concluded that it was, and the Board agreed.

STATUTE INVOLVED

Section 8(b)(7) of the Act provides, in relevant part:

(b) It shall be an unfair labor practice for a labor organization or its agents—

(7) to picket or to cause to be picketed, or threaten to picket or cause to be picketed, any employer where an object thereof is forcing or requiring an employer to recognize or bargain with a labor organization as the representative of his employees, or forcing or requiring the employees of an employer to accept or select such labor organization as their collective bargaining representative . . .

* * *

(C) where such picketing has been conducted without a petition under section 159(c) of this title being filed within a reasonable period of time not to exceed thirty days from the commencement of picketing: Provided . . .: Provided further, That nothing in this subparagraph (C) shall be construed to prohibit any picketing or other publicity for the purpose of truthfully advising the public (including consumers) that an employer does not employ members of, or have a contract with, a labor organization, unless an effect of such picketing is to induce any individual employed by any other person in the course of his employment, not to pick up, deliver or transport any goods or not to perform any services.

QUESTION PRESENTED

The sole question presented here is: Was any object of the picketing to force recognition or bargaining?

SUMMARY OF ARGUMENT

The Board's decision has three bases:

1. A recognitional object is implicit when a union seeks to require an employer to put into effect and maintain the identical employment terms and benefits defined in the union's area-wide collective bargaining agreement; and that is what happened here.

2. Respondents sought to compel intervenor to adopt their contracts.

3. Intervenor's adoption of the contracts was its only practical alternative to Respondents' economically impossible demands.

Each basis finds support in the facts and the law. In addition there is a fourth basis. It is the totality of Respondents' conduct.

ARGUMENT

PRELIMINARY STATEMENT

Section 8(b) (7) was enacted in 1959 as part of the Landrum-Griffin amendments to the Act. Recognition or organization need not be the sole or principal object of the picketing. A violation occurs if *any* object of the picketing is to force recognition or bargaining. *National Packing Co. v. NLRB,* 377 F.2d 800 (10th Cir. 1967). That issue is a question of fact. *NLRB v. Suffolk County District of Carpenters,* .... F.2d ...., 56 LC No. 12,351 (2nd Cir., December 13, 1967). The Board's finding on it is determinative if supported by substantial evidence. *Universal Camera Corp. v. NLRB,* 340 U. S. 474, 488; *NLRB v. Butchers Union, Local No. 120* .... F.2d ...., 57 LC No. 12,560 (9th Cir., February 21, 1968, No. 21,742).

IMPLICIT OBJECT

In this case an object to force recognition or bargaining was implicit in the very nature of Respondents' demands.

Three key facts are uncontroverted:

1. Respondents defined the "standards" they sought as the identical employment terms and benefits provided for in their collective bargaining agreements with other store owners. (Tr. 236-237).

2. Intervenor's costs were immaterial. (Tr. 153).

3. Intervenor was to change its "standards" as Respondents' collective bargaining agreements changed. (Tr. 65, 177).

After the enactment of Section 8(b) (7), "recognitional" or "organizational" picketing to compel recognition or bargaining was prohibited unless a timely election petition was filed. On the other hand, "advertising", "informational" or "publicity" picketing to advise the public that an employer does not employ members of, or have a contract with a union was expressly permitted if deliveries were not interfered with.

A third form of picketing evolved. It has been referred to as "area standards" picketing and may be defined as a protest against alleged "substandard" conditions. It has been permitted even though deliveries are interfered with. In effect, the area standards doctrine is an exception to the restrictions imposed by the Landrum-Griffin amendments to the Act.

The basic premise of the Board's decision in this case is that the area standards doctrine need go no further than to accord a union a means, apart from organization and recognition, of preventing the un-

organized employer from obtaining a competitive advantage over the organized employer, and that the lawful object effectively can be achieved by assuring that the unorganized employer is required to pay employee costs equivalent to those paid by the organized employer, but that when the union seeks to require and maintain the identical employment terms and benefits as defined in its collective bargaining agreements with other employers, it goes beyond the lawful object.

The premise is sound.

The first Section 8(b) (7) decision involving area standards picketing is *Houston Building & Construction Trades Council* (*Claude Everett Construction Co.*) 136 NLRB 321 (1962). The objective of the picketing involved "was to induce the Company to raise its wage rates to the union scale prevailing in the area". (136 NLRB 321, at 323).

The opinion refers to *International Hod Carriers, etc., Local 41* (*Calumet Contractors Association*), 133 NLRB 512 (1961), an earlier decision which arose under Section 8(b) (4). In that case, the union sought to require the Employer "to conform standards of employment to those prevailing in the area". (133 NLRB 512). However, there is no indication in the decision or in a prior decision in the case (130 NLRB 78) of what the "standards" were, how they were defined, or how they were to be applied.

Everett was followed by *Local 741, United Assn. of Journeymen, etc.* (*Keith Riggs Plumbing and Heating Contractor*), 137 NLRB 125 (1962).

In *Keith Riggs* the Union sought to compel Riggs to "raise his wage scale to the standards prevailing in union contracts". (137 NLRB 1125, 1139). The Union's defense was that "its sole object was to require Riggs to pay the Plumbers' wage scale prevailing under its contracts with employers in the area". (137 NLRB 1125, at 1134). The Union's business agent testified that the Union's "sole interest was that Riggs pay the prevailing wage scale for plumbers in the area". (137 NLRB 1125, at 1127).

In *International Hod Carriers etc.* (*Texarkana Construction Co.*), 138 NLRB 10 (1962), area standards picketing was permitted where the purpose of the picketing was to induce the employer to raise its wages to the level of the prevailing rate for the area.

In *United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry, etc.* (*Foor Engineering Co.*), 143 NLRB 54 (1963), the Union sought to require the Employer to "hire four pipefitters, since he expected to use four welders",[4] and to pay in addition to the Union scale of wages, 30 cents per hour to a welfare fund. The Trial Examiner, whose decision was adopted, found a violation of Section 8(b) (7). He concluded that the Union's objective was to require Foor to adhere to and operate under the terms of the Union's area contract with other employers. The union objective is the same in

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[4]By analogy, both the Retail Clerks and the Meat Cutters Industry agreements in the present case restrict the number of apprentices in proportion to other employees. (G. C. Exh. No. 2, Article VI, Sec. M, p. 12, and July 1, 1964, Amendment; and G. C. Exh. No. 3, Article 22, Section A, p. 13).

this case. As noted in *Foor,* it is equivalent to forcing or requiring the Employer to recognize or bargain with the Union.

The thrust of the area standards decisions has been recognition of union concern about competitive advantage to be gained by nonunion employers over union employers, thereby jeopardizing the job security of union employees. The force of competition can be met if the unorganized employer is compelled to incur costs which equal those incurred by organized employers.

How the unorganized employer apportions the costs should be up to him. If the Union wants to tell him how, and it wants him to change whenever its contracts change, then quite obviously, its concern is more than competitive advantage.

In *Centralia Bldg. & Trades Council v. NLRB,* 363 F. 2d 699 (D.C. Cir. 1967), a Union sought a written agreement under which the Employer would have obligated itself to pay to its employees "a total amount either by way of wages or fringe benefits equivalent to the amount of the total economic package being received by employees working under the Union Agreement". As the Union Agreement was renegotiated from time to time, the Employer's total economic package was to change accordingly. The Union made "no substantial effort" to ascertain the employer's actual wage or employment standards before instituting its picketing. The Union disclaimed any recognitional objective. The Board concluded that a violation of Section 8(b) (7) was implicit in the

nature of the Union's demand. The Board's decision is enforced by the Court.

The Court recognized that with such an agreement in effect, little would be left for an employees' representative to negotiate.

In the present case no written agreement was sought by Respondents. The Trial Examiner found that no "agreement as such" was sought. Intervenor objected to this finding in the proceedings before the Board because contractual assent may be based on conduct as well as writings or words. *Restatement of Contracts* (A. L. I.), Section 21.

However, the rationale of *Centralia* does not depend on the presence or absence of an agreement. The rationale is that if what the Union seeks to require the Employer to do has the same "net effect" as entering into a collective bargaining agreement, it is proscribed. See, *Hotel & Restaurant Workers of Las Vegas* (*Holiday Inns*), 169 NLRB No. 102.

Whatever benefits State-Mart was to provide its employees were to be keyed to Respondents' industry agreements. (Tr. 153). The benefits were to be changed whenever the agreements changed. Respondents' principal spokesman explained that State-Mart would be expected to maintain standards in the area, whatever they might be, and for whatever time they would be in effect. (Tr. 177). The understanding of Edward Young, State-Mart's president, that "each time the union gets more benefits, you have to change with it" (Tr. 65), is not disputed.

This case presents a clearer violation of Section 8(b) (7) than did *Centralia.* In *Centralia,* the request was for equal costs. The vice was that the costs were to change as the union's collective bargaining agreement changed. Here, the demand goes beyond costs. The identical terms and benefits must be provided.

CONTRACT ADOPTION

As noted in the Statement of the Case, Respondents handed Intervenor copies of their collective bargaining agreements at the San Luis Obispo meeting. Respondents marked out clauses specifically relating to recognition and union security, but did not mark out a number of other clauses which smack of bargaining, among them discharge procedures and seniority provisions, apprentices, timing of store meetings not to conflict with union meetings, grievance and arbitration procedures, and provisions having to do with health and welfare and pension trust funds.

Respondents' position is that their spokesmen made no effort to strike all clauses deemed inapplicable. However, their chief spokesman, Schwartz, testified that the agreements were produced to show what the "standards" were, that he did not state that there were some benefits Respondents did not want, and that none were negotiable. (Tr. 173).

The Board adopted its Examiner's finding that Intervenor reasonably assumed that all of the provisions not specifically stricken were applicable if it were to

undertake to conform to area standards. In itself the finding is reasonable.

PRACTICAL IMPOSSIBILITY

In two ways, the nature of Respondents' demands posed economic and practical impossibilities for Intervenor. The alternative was to "go union", just as a horse turns to avoid the pressure of a bit.

First, Respondents' insistence on *identical* health, welfare and pension benefits put Intervenor in the position of having to provide 50 to 70 employees with the very same benefits provided by collective bargaining agreements for approximately 20,000 retail clerks and approximately 10,000 butchers. (Tr. 180, 233). It was within the Board's *expertise* to conclude, as it did, that the difference in comparative costs of equivalent benefits for the two groups presented Intervenor with a virtual economic impossibility.

Second, the only way Intervenor could have provided the benefit of portability of pension credits, as that benefit is defined in Respondents' collective bargaining agreements, was to have signed Respondents' agreements. Credits survive only if transferred from one signatory to the agreement to another signatory.

Respondents deny that they ever mentioned portability. (Tr. 162). Whether they did is immaterial. They did not exclude it. It is one of the benefits provided for in the agreements they produced.

Schwartz admits that he discussed pensions with Intervenor's spokesman. He then testified (Tr. 171, lines 10-16):

"Q. (By Mrs. Robbins) Yes. These are generalities, you know. A pension can be many things.

A. I think pension means a specific thing to somebody in this business, and health and welfare means something to somebody else in this business.

Mr. Frame is a practitioner in this business, and I am sure he knows."

Respondents argued during the Board proceedings that Intervenor could have compensated for portability by setting up a special bank account of some sort. How in Respondents' judgment that would have worked, both as to employees coming to work for Intervenor from union employment and as to employees going from Intervenor to union employment, never did appear.

The point, we suppose, is this: *Identical* benefits are what Respondents demanded. The *identical* benefit as to portability is transfer of credits.

TOTALITY OF CONDUCT

Another basis for the Board's decision is one it did not choose to rely on. It is the totality of Respondents' conduct.

Considering all of Respondents' conduct including what happened at the meeting in San Luis Obispo, the mass picketing, the obscenities, the obstruction of customers' ingress and egress, the joining together of several labor organizations, and the subsequent inter-

ruption of almost all deliveries certainly supports a conclusion that the picketing was aimed at something more than so-called "area standards".

The Trial Examiner observed that if standards picketing is to be permitted, then there is no reason to preclude vigorous standards picketing. However, in other cases the Board has not hesitated to consider all the circumstances. See, e.g., *Local 3, Int'l Brotherhood of Electrical Workers (Atlas Reid, Inc.),* 170 NLRB No. 73 (1968), and *Truck Drivers Local 649 (Cold Springs Construction Co.),* 162 NLRB No. 152 (1967).

The Second Circuit recently recognized that interruption of deliveries, as such, raises an inference of an impermissible purpose. *NLRB v. Suffolk District Council of Carpenters,* supra, ... F. 2d ...., 56 LC No. 12,351 (2nd Cir. December 13, 1967). As therein stated,

> "Such attempts demonstrate an intent to force both the employer and employees into a position more conducive to union recognition or organization demands. See Cox, The Landrum-Griffin Amendments to the National Labor Relations Act, 44 Minn. L. Rev. 257, 267-68 (1959). The employer may suffer serious loss if he either cannot receive deliveries or must expend substantial special time and effort, because of the picketing, in going outside his usual operations to obtain essential materials. Recognition may be his only recourse if he wishes to maintain profitable operations. Similarly, the employee's choice whether or not to belong to the union cannot be freely exercised; organization with the picketing union

may be necessary to ensure continuance of their jobs. This is the aspect of picketing which Congress specifically meant to control when it forbade 'forcing or requiring' recognition or organization by picketing for more than 'a reasonable period of time' without the filing of a petition for an election."

CONCLUSION

For the reasons herein stated, together with such arguments as may be advanced therefor by the General Counsel in his brief, enforcement of the Board's order should be granted.

Dated, Coalinga, California,
May 3, 1968.

Frame & Courtney,
Ted R. Frame,
Attorneys for Intervenor
State-Mart, Inc.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Ted R. Frame,
Attorney for Intervenor.

No. 22,515

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

RETAIL CLERKS INTERNATIONAL ASSOCIATION, LOCAL UNION NO. 899, AFL-CIO; AMALGAMATED MEAT CUTTERS AND BUTCHER WORKMEN OF NORTH AMERICA, LOCAL UNION NO. 556, AFL-CIO; INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, LOCAL UNION NO. 381; INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, JOINT COUNCIL OF TEAMSTERS NO. 42, AND SAN LUIS OBISPO BUILDING AND CONSTRUCTION TRADES COUNCIL, AFL-CIO,

Respondents.

Brief for Respondent Amalgamated Meat Cutters and Butcher Workmen of North America, Local Union No. 556, AFL-CIO.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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Respondents.

Brief for Respondent Amalgamated Meat Cutters and Butcher Workmen of North America, Local Union No. 556, AFL-CIO.

JURISDICTION.

This case is before the Court upon the petition of the National Labor Relations Board, pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151, *et seq.*),

for enforcement of its order [R. 71; 33][1] issued against the respondents on July 23, 1967, and reported at 166 NLRB No. 92. This court has jurisdiction of the proceeding under Section 10(e), the alleged unfair labor practices having occurred at Arroyo Grande and San Louis Obispo, California.

STATEMENT OF THE CASE.

I.

The Board's Findings of Fact.

Briefly, the Board found that the respondent Unions violated Section 8(b)(7)(C) of the Act by picketing the Company stores for more than thirty days without the filing of an election petition and with a proscribed recognitional objective. The evidence upon which the Board based its findings is as follows:

A. The Picketing of the Company Stores.

State Mart, Inc., hereinafter referred to as the Company, is engaged in the operation of two retail food stores in Southern California, one in Arroyo Grande and the other in San Luis Obispo [R. 34; Tr. 67]. At no time pertinent to the issues involved herein were the employees at either store represented by a labor organization [R. 35]. No election has ever been held to determine the employees' choice in regard to unionism; nor

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[1]References designated "R" are to Volume I of the record as reproduced pursuant to rule 10 of this Court. "Tr." references are to the reporter's transcript of testimony as reproduced in volume II of the record.

has any labor organization sought to obtain such an election (*Ibid.*).

Respondent, Retail Clerks International Association, Local Union No. 899, hereinafter called Retail Clerks, and respondent, Amalgamated Meat Cutters and Butcher Workmen, Local Union No. 856, hereinafter called Meat Cutters, established picket lines at both stores with signs reading as follows [R. 35; Tr. 74]:

> "This market unfair because they do not pay the prevailing wage rates or benefits paid by other markets in the area. Members of Retail Clerks Local 899 and Meatcutters Local 556, AFL-CIO, protest the substandard wage rates paid in this market." [R. 35; Tr. 96, 127-128].

B. The February 1 Meeting.

On January 27, 1966, Company attorney Ted R. Frame telephoned Kenneth Schwartz, counsel for the Retail Clerks, in order to find out what could be done to bring about the removal of the picket line [R. 36; Tr. 13-14, 149]. In response to this inquiry, Schwartz stated that the picket lines would be lifted if the Company would adhere to the wages and working conditions prevailing in the area. The Union and Company representatives agreed to meet at a future date for the purpose of defining the precise nature of "area standards."

The meeting took place on February 1, 1966 [R. 37; Tr. 15, 151]. At the outset, Schwartz, acting as spokesman for the Retail Clerks and Meat Cutters, stated that the meeting was being held solely to advise

the Company "what we meant by standards in this particular area" and that the Unions did not intend either to "ask for an organization" or to "negotiate an agreement" [R. 37; Tr. 152]. Schwartz proceeded to set forth the Unions' definition of area standards, stating that such standards encompass not only wages but also "fringe benefits" and "other benefits", including health and welfare plans, pensions and vacations [R. 37; Tr. 153]. Schwartz emphasized that the Company "was to maintain the standards in the area, whatever the standards would be, and for whatever time the standards were in effect" [Tr. 177]. At this point, the Union representatives produced copies of the area bargaining agreements [R. 37; Tr. 20, 156-158] after striking therefrom certain clauses which would obviously not bear upon the question of area standards [R. 37-38; Tr. 158-160].

Schwartz, further stated that in presenting the contracts *he did not "want it to be construed that [he was] making any demands* but [he wanted the Company] to know the *type of benefits* the employees enjoy under our agreement, *to explain the area standards"* [R. 37; Tr. 158; emphasis supplied.] When the Company representatives inquired as to the possibility of *modifying* certain of the area standards, the Unions stated that the meeting was not a negotiating session, that none of the benefits were subject to negotiation, and that the contracts spoke for themselves in regard to the definition of the benefits [R. 39; Tr. 18, 173].

At the conclusion of the meeting, the Company representatives stated that they would be unable to make an immediate decision in regard to the matter and the picketing continued. *At no time did any Company representative disagree with the Union definition of area standards.*

II.

The Board Conclusion and Order.

Upon the foregoing facts, the Board found that the respondent Unions had violated Section 8(b)(7)(C) of the Act by picketing the Company stores for more than thirty days without the filing of an election petition and with a proscribed recognitional objective. The Board issued an order requiring all respondent Unions to cease and desist from the unfair labor practices found and to post the appropriate notices [R. 71; 33].

ISSUE.

The issue before the Court is—Did the Board properly find that the Respondent Unions had a recognitional objective when they picketed the Company's stores.

ARGUMENT.

The Board finding that picketing by the Respondent Unions was in violation of Section 8(b)(7)(C) of the Act, is improper, in that it is not supported by substantial evidence.

A. Introduction.

Section 8(b)(7), part of the 1959 Amendments to the Act, governs recognitional and organizational picketing. Sub-Section (C) of 8(b)(7) prohibits picketing by an uncertified Union where an object of the picketing is "forcing or requiring an employer to recognize or bargain with a labor organization as the representative of his employees," if such picketing has been conducted for more than 30 days without the filing of a petition for election.

B. Respondent Unions Only Interest Was in the Preservation of Area Standards.

The law is clear that a Union may picket an employer for the purpose of compelling compliance with prevailing area wage and benefit standards. The Board regards such picketing activity, "area standards picketing", as non-recognitional and not prohibited by Section 8(b)(7)(C).

Local Union 741, Plumbers Union (Keith Riggs Plumbing and Heating Contractor), 137 NLRB 1125;

McLeod v. Chefs, Cooks, Pastry Cooks Local 89 (Stork Restaurant), 280 F. 2d 760.

The Board in its opening brief at page 9 agrees that "In the instant case Respondent Unions have consistently described their picketing as motivated sole-

> ly by such a permissible area standards object. Undeniably, the formal declarations of Union representatives and the legends of the picket signs were entirely consistent with this purported objective. Moreover no direct demands for representative status were ever made and, in fact, on several occasions, the Unions expressly disclaimed all recognitional ambitions."

In the face of the foregoing, the Board then contends at page 9 of its opening brief:

> "The Board is not bound by a Union's self serving description of its own objective."

There is, however, no evidence of any kind or nature that would indicate;

(1) That the Unions had any objective other than the preservation of area standards, or

(2) That this was in fact a self serving description of the Unions' objective.

Every act on the part of the Unions was consistent, with their avowed objective, that of preserving area standards.

The Board appears to be saying in its opening brief that there was some conduct, "actual conduct", on the part of the Unions that reflects an underlying recognitional object. Again, this is not borne out by the evidence.

The Unions did not at any time claim that they represented the employees. The Unions did not at any time ask for a contract with State-Mart. The Unions were explicit in their statements that they were not at the meeting of February 1, 1966, to negotiate a contract.

The sole objective of the Unions was to create a situation where the employer would be paying to his employees wages and benefits equivalent to those prevailing in the area. In short, the Unions were interested in preserving the area standards.

In furtherance of this legitimate objective, when asked what are the area standards, the Unions replied that the area standards were in essence contained in their contracts with other employers in the area. This is a truthful statement, it represents the facts as they were on February 1, 1966, and as they now exist.

The evidence at the hearing was to the effect that the area is largely organized by the Unions, and that those Union contracts therefore are in fact representative of area standards for the food market employees within that area.

Further, area standards embraces more than mere costs to the employer. A labor organization has a legitimate interest apart from recognition or bargaining to require that employers meet prevailing wage scales in an area, and that employers meet prevailing employee benefits.

Keith Riggs, supra.

Reference is made in the Board's and Intervenors opening briefs, to the fact that the Union contracts as submitted to the employer contained certain provisions, namely a grievance and arbitration provision, and pension provisions, the inclusion of which point up the fact that the demand of the Unions was in fact recognitional.

The presentation of the contracts and the contents of those contracts must be considered within the frame-

work, and in the context in which they were presented to the employer. It was made clear to the employer that the contracts were given to Mr. Frame as an example of the area standards. The contracts were not given Frame for the purpose of negotiating a contract between the employer and the Unions. Obviously under these conditions neither side, the employer, or the Unions, could reasonably have believed that a Union-Employer grievance and arbitration provisions was contemplated as part of the area standards. Representation was expressly disclaimed by the Unions at all times.

Further, there is nothing improper in assuming that a pension arrangement for employees, a cost item, is part of area standards where such pension is in fact in effect within that area. It is submitted that the Unions were within their rights in asking that the pension be included as part of the area standards.

The contention of Intervenor, that the pension provisions required a contract with the Unions, is entirely without any basis in fact. The employer was free to provide such benefits in whatever manner he was able so to do. It is not unreasonable to require that the employer provide a pension plan equal to that in effect within the area. It is not unreasonable to require that the employer meet all of the area standards, including the pension, and not merely wages.

Neither the Courts nor the Board have used cost alone as a sole determining factor in area standards cases. If the employer is sufficiently convinced that he does not wish to be an organized employer, he must logically take the position that he does not wish to be an organized employer at any cost. Therefore to ask him to comply with area standards by providing equal wages

and equal benefits, including pension, is not asking for more than the employer should expect to provide.

Nor is there anything improper contained in the provisions of the Meat Cutters Pension Plan, and more particularly page 17 Paragraph J thereof, as is set forth in General Counsel's Exhibit 4. Paragraph J is attached hereto as Appendix A.

That paragraph is in fact nothing more than a provision for early vesting of a pension. It provides:

1. That a meat cutter employed for 24 months shall have his pension rights vest, provided
2. That upon transfer of employment he transfers to employment similar to that at which he had worked for the 24 month period.

This pension provision is not dependent upon Union membership or participation in any way whatsoever. There is no reason why the employer could not offer its employees the same pension benefit.

What the Board is in effect saying is that the sum total of the demands made upon the employer was more than he could reasonably meet and still stay in business; "The most practical alternative is the adoption of the Union contract".

The Board in adopting the Trial Examiner's reasoning is reaching a conclusion that is not substantiated by or warranted by the evidence. The employer is not faced with the alternative of adopting the Union contract. The employer was not offered that alternative, there is no evidence that any Union representative ever offered to enter into a contract with the employer. Further, the employer may or may not have been considering the actual cost.

The Trial Examiner's decision adopted by the Board states at page 13 of that decision:

> "The record is barred of evidence as to the cost of equivalent health and welfare or pension benefits if State-Mart be required to supply them from a source other than the contract plans and trusts."

With the record barren of such evidence, the Trial Examiner then concludes that the cost to an individual employer as contrasted to the contract employer under group plans or trusts "would present a virtual economic impossibility."

The Trial Examiner then proceeds further to conclude, without a shred of evidence to support the conclusion:

> "The most obvious way that State-Mart could provide equivalent benefits at a feasible cost would be for it to become party signatory to the contracts and thus to become eligible to avail itself of the trust funds."

The Trial Examiner further concludes, and likewise without any evidence in support of his position:

> "These contracts were before it, and appeared as a practical alternative to an economically impossible demand."

From the above reasoning based upon no evidentiary finding, the Trial Examiner concludes:

> "Presenting an employer with a demand that it cannot reasonably meet and still stay in business and placing this in a context where the most practical alternative is the adoption of a union contract, gives rise to an inference that the unions' express disclaimers of a recognitional or bargaining object may be a mere pretext . . ."

There is no showing whatsoever that there was any demand made that the employer could not reasonably meet and still stay in business, nor is there any showing that the most practical alternative is the adoption of a union contract.

It may very well be that from the employer's standpoint the adoption of a union contract, even though it may cost less money, is a very impractical alternative.

From the foregoing it appears that what the Trial Examiner has said, and what the Board has upheld, is a ruling that suggests that a Union can request an employer to comply with area standards and thereby raise the employers wage rates and improve the employee benefits to the levels within the area, only if the employer agrees that it is economical and convenient so to do; and that if the employer finds it uneconomical and impractical then the Union will be found to have demanded recognition.

The above conclusions are entirely without basis in fact or evidence, or in the law.

The Board and the Courts have, on numerous occasions, stated:

> "Conclusions based on surmise or conjecture cannot stand."
>
> *NLRB v. Covington Motor Co.,* 344 F. 2d 136 (C.A. 4, 1965);
>
> *NLRB v. Deerfield Screw Prod. Co.,* 329 F. 2d 558 (C.A. 6, 1964).

The Board in its opening brief at page 11 anticipates the Unions' reliance on *Local 741 Plumbers Union (Keith Riggs Plumbing)*, 137 NLRB 1125:

We do cite that case; not out of context as suggested by the Board, but fully and entirely; the portion of *Keith Riggs* that is pertinent to the instant case appears at page 1127 of the majority opinion:

> "Our dissenting colleagues point to no evidence which would indicate *that respondent* [*union*] *was* insincere in its statements that it was not seeking *to negotiate with Riggs.* They merely assert, as they have elsewhere, . . . that picketing to compel a change in wages and working conditions 'necessarily' is for the purpose of recognition and bargaining. *This is stated as virtually a proposition of law. There is no judicial or legislative support for any such proposition. If Congress had intended to ban all picketing after thirty days, which is substantially what the dissenting view would accomplish, it could have achieved that objective in straight-forward and simple language.* We hold, therefore, as did the Trial Examiner, that the picketing on the evidence in this case did not have for an object recognition or bargaining." (Emphasis supplied).

In the instant case as in *Keith Riggs,* the Unions have a legitimate interest other than recognitional; to see that all employers, organized or not, meet area wage scales and area employee benefits, for the reason that employers committed to less, undermine area standards.

There is no evidence whatever in the instant case to substantiate a finding that the Unions were in any manner or at all insincere in their statements that they were not seeking to negotiate a contract with the employer. There is nothing in the evidence to substantiate the contemplation of a Union—Union member-employer relationship.

Area standards are not measured by whether the employer can afford to meet those area standards, but are in fact measured by the level of *wages and benefits,* and not by cost. (*Keith Riggs, supra*). In furtherance of such objective, the Unions have a right to peacefully picket.

The Board in adopting the decision of the Trial Examiner is acting in exactly the manner proscribed by the Court in *Keith Riggs.* The Board is stating "virtually as a proposition of law" that

> "Where a Union is not content with equalizing labor cost but requires adoption of details identical with Union contract, a recognitional objective is established, *and no further showing need be made.*" (Emphasis added).

The Board is in fact saying no matter what your avowed purpose, no matter how carefully or fairly you comply with the rules laid down in previous Board and Court decisions, no matter what you say, or how you act, we find *as a matter of law,* that you have demanded recognition.

It is submitted that a finding and decision such as this is improper under the law and is improper under the evidence in the instant case.

Reasonably and logically the cases that define "area standards picketing" vs. "recognitional picketing" agree that wages and benefits are of concern in area standards; that where a Union—Union member-employer relationship is contemplated the picketing is recognitional. (The term recognitional obviously assumes that the Union have members employed by employer and that it be recognized as a bargaining agent.)

The rules and boundaries have been laid down as set forth herein; the Unions complied with the rules and remained within the designated boundaries of "area standards picketing". To hold otherwise is to completely obliterate area standards picketing and to take away from Unions their right to establish equality of wages and benefits in a given area.

Here, there is no evidence whatever to indicate recognitional picketing on the part of the Unions. Cases cited by the Board such as *Centralia Bldg. and Const. Trades Council v. N.L.R.B.*, 363 F. 2d 699, and *N.L.R.B. v. Carpenters Local 2133,* 356 F. 2d 464, do not apply.

Conclusion.

For the reasons herein stated it is respectfully submitted that enforcement of the Board's order should be denied.

Charles M. Arak,
Attorney for Amalgamated Meat Cutters and Butcher Workmen of North America, Local Union No. 556, AFL-CIO.

Dated: June 11, 1968.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CHARLES M. ARAK

APPENDIX A.

J. Preservation of Pension Credits.

An employee in the industry employed by an Employer pursuant to a collective bargaining agreement with Meat Cutters Locals No. 421, 551, 439, 556 and 587 and who has acquired service credits under the Southern California Meat Cutters Unions and Food Employers Pension Trust Fund shall be entitled to preservation of such service credits under the following conditions:

1. That he has earned service credits of at least twenty-four (24) months under the Southern California Meat Cutters Unions and Food Employers Pension Trust Fund.

2. Provided such employee meets the requirement in (1) above, such employee on transferring to employment similar to that for which service credit would be earned under the Southern California Meat Cutters Unions and Food Employers Pension Trust Fund in the industry, to any other employer in the state of California, shall have his pension credits preserved, provided further that evidence satisfactory to the Trustees of this Trust is submitted showing that the employee remained in employment similar to employment covered by the Southern California Meat Cutters Unions and Food Employers Pension Trust Fund in the state of California, for a time sufficient to complete ten (10) years of future credited service under the Southern California Meat Cutters Unions and Food Employers Pen-

sion Trust Fund and such other similar trust fund. Then his credited past service and his future credited service of less than ten (10) years under the Southern California Meat Cutters Unions and Food Employers Pension Trust Fund shall become vested and shall be preserved by this Trust.

3. The rules and regulations, break in service rules, other pertinent provisions, amendments and regulations in connection with the Southern California Meat Cutters Unions and Food Employers Pension Trust Fund shall apply to all persons affected by this resolution.

No. 22,515

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

RETAIL CLERKS INTERNATIONAL ASSOCIATION, LOCAL UNION NO. 899, AFL-CIO; AMALGAMATED MEAT CUTTERS AND BUTCHER WORKMEN OF NORTH AMERICA, LOCAL UNION NO. 566, AFL-CIO; INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, LOCAL UNION NO. 381; INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, JOINT COUNCIL OF TEAMSTERS NO. 42, AND SAN LUIS OBISPO BUILDING AND CONSTRUCTION TRADES COUNCIL, AFL-CIO,

Respondents.

Brief for Respondent Retail Clerks International Association, Local Union No. 899.

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Respondents.

Brief for Respondent Retail Clerks International Association, Local Union No. 899.

JURISDICTION.

This case is before the Court upon the petition of the National Labor Relations Board, pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec.

151, *et seq.*),[1] for enforcement of its order [R. 71; 33][2] issued against the respondents on July 23, 1967, and reported at 166 NLRB No. 92. This court has jurisdiction of the proceeding under Section 10(e), the alleged unfair labor practices having occurred at Arroyo Grande and San Luis Obispo, California.

STATEMENT OF THE CASE.

I.
The Board's Findings of Fact.

Briefly, the Board found that the respondent Unions violated Section 8(b)(7)(C) of the Act by picketing the Company stores for more than thirty days without the filing of an election petition and with a proscribed recognitional objective. The evidence upon which the Board based its findings is as follows:

A. The Picketing of the Company Stores.

State Mart, Inc., hereinafter referred to as the Company, is engaged in the operation of two retail food stores in Southern California, one in Arroyo Grande and the other in San Luis Obispo [R. 34; Tr. 67]. At no time pertinent to the issues involved herein were the employees at either store represented by a labor organziation [R. 35]. No election has ever been held to determine the employees' choice in regard to unionism; nor has any labor organization sought to obtain such an election (*Ibid.*).

---

[1]The pertinent statutory provisions are set forth in Appendix B of the Board's Opening Brief.

[2]References designated "R." are to Volume I of the record as reproduced pursuant to rule 10 of this Court. "Tr." references are to the reporter's transcript of testimony as reproduced in Volume II of the record.

Respondent, Retail Clerks International Association, Local Union No. 899, hereinafter called Retail Clerks, and respondent, Amalgamated Meat Cutters and Butcher Workmen, Local Union No. 856, hereinafter called Meat Cutters, established picket lines at both stores with signs reading as follows [R. 35; Tr. 74]:

> "This market unfair because they do not pay the prevailing wage rates or benefits paid by other markets in the area. Members of Retail Clerks Local 899 and Meatcutters Local 556, AFL-CIO, protest the substandard wage rates paid in this market." [R. 35; Tr. 96, 127-128].

B. The February 1 Meeting.

On January 27, 1966, Company attorney Ted R. Frame telephoned Kenneth Schwartz, counsel for the Retail Clerks, in order to find out what could be done to bring about the removal of the picket line [R. 36; Tr. 13-14, 149]. In response to this inquiry, Schwartz stated that the picket lines would be lifted if the Company would adhere to the wages and working conditions prevailing in the area. The Union and Company representatives agreed to meet at a future date for the purpose of defining the precise nature of "area standards."

The meeting took place on Februry 1, 1966 [R. 37; Tr. 15, 151]. At the outset, Schwartz, acting as spokesman for the Retail Clerks and Meat Cutters, stated that the meeting was being held solely to advise the Company "what we meant by standards in this particular area" and that the Unions did not intend either to "ask for an organization" or to "negotiate an agreement" [R. 37; Tr. 152]. Schwartz proceeded to set

forth the Unions' definition of area standards, stating that such standards encompass not only wages but also "fringe benefits" and "other benefits," including health and welfare plans, pensions and vacations [R. 37; Tr. 153]. Schwartz emphasized that the Company "was to maintain the standards in the area, whatever the standards would be, and for whatever time the standards were in effect" [Tr. 177]. At this point, the Union representatives produced copies of the area bargaining agreements [R. 37; Tr. 20, 156-158] after striking therefrom certain clauses which would obviously not bear upon the question of area standards [R. 37-38; Tr. 158-160].

Schwartz further stated that in presenting the contracts *he did not "want it to be construed that [he was] making any demands* but [he wanted the Company] to know the *type of benefits* the employees enjoy under our agreement, *to explain the area standards*" [R. 37; Tr. 158; emphasis supplied.] When the Company representatives inquired as to the possibility of *modifying* certain of the area standards, the Unions stated that the meeting was not a negotiating session, that none of the benefits were subject to negotiation, and that the contracts spoke for themselves in regard to the definition of the benefits [R. 39; Tr. 18, 173].

At the conclusion of the meeting, the Company representatives stated that they would be unable to make an immediate decision in regard to the matter and the picketing continued. *At no time did any Company representative disagree with the Union definition of area standards.*

II.

The Board Conclusion and Order.

Upon the foregoing facts, the Board found that the respondent Unions had violated Section 8(b)(7)(C) of the Act by picketing the Company stores for more than thirty days without the filing of an election petition and with a proscribed recognitional objective. The Board issued an order requiring all respondent Unions to cease and desist from the unfair labor practices found and to post the appropriate notices [R. 71; 33].

ARGUMENT.

The Board Finding That the Respondent Unions Had a Proscribed Recognitional Objective and That Their Picketing Was Violative of Section 8(b)(7)(C) of the Act Is in Error Since Not Supported by Substantial Evidence.

A. Introduction.

Section 8(b)(7), enacted as part of the 1959 amendments to the Act, constitutes a comprehensive code governing recognitional and organizational picketing. Subsection (C) of Section 8(b)(7), which is involved herein, prohibits picketing by an uncertified Union where an object thereof is "forcing or requiring an employer to recognize or bargain with a labor organization as the representative of his employees," if such picketing has been conducted for more than thirty days without the filing of an election petition.

The sole issue before the Court is whether the Board properly found that the respondent Unions had a recognitional objective when they picketed the Company's stores.

B. Respondents' Sole Object in the Picketing Was the Preservation of Area Standards.

It is freely acknowledged by the Board that when a Union pickets an employer for the sole purpose of compelling compliance with prevailing area *wage and benefit* standards, the Board regards the picketing activity —so-called "area standards" picketing—as non-recognitional and outside the prohibition of Section 8(b)(7)-(C). *McLeod v. Chefs Cooks, Pastry Cooks & Assistants, Local 89 (Stork Restaurant),* 280 F. 2d 760 (C.A. 2d 1960). Prior to *Stork Restaurant,* as will appear, the Board took a contrary view.

As the Board has conceded in its Opening Brief, herein at page 2:

> "The respondent Unions have consistently described their picketing as motivated solely by such a permissible area standards object. Undeniably, the formal declarations of Union representatives and the legends of the picket signs were entirely consistent with this purported objection. Moreover, no direct demands for representative status were ever made and, in fact, on several occasions, the Unions expressly disclaimed all recognitional ambitions."

The Board, however, contends that the Unions engaged in "actual conduct [which] reflects an underlying or accompanying recognitional object." (Board Brief, p. 9). Such "actual conduct" was no more than the Union's specificity in reply when asked by the Company to define what the area standards were. It was the Company, not the Union, that sought to "bargain" concerning the standards and the Union's reply that the area standards were not subject to the negotiation.

We show below that the Union conditions to removal of the picket lines were solely in terms of maintaining area standards and were in no sense a request for recognition.

In *Calumet Contractors Assn.,* 133 NLRB 512 (1961), following *Stork Restaurant, supra,* the Board overruled its earlier view of area standards picketing and held, in effect, that a Union might lawfully picket for objects normally achieved through collective bargaining, *if the immediate object of the picketing was not recognition.* See *Fanelli Ford Sales Inc.,* 133

NLRB 1468; *Mission Valley Inn,* 140 NLRB 433; *Hod Carriers, Local 840 (Blinne Const. Co.),* 135 NLRB 1153.

The Board has held that picketing aimed at requiring unorganized employers to adopt the specific benefits contained in area contracts is permissible *area standards* picketing. *Local 741 Plumbers Union (Keith Riggs Plumbing),* 137 NLRB 1125. The Board anticipates our citing of *Keith Riggs* in its footnote 11 on page 11 of its Brief whereat it incorrectly assumes that we will cite *Keith Riggs* out of context. At page 1127 the majority in *Keith Riggs* states:

> "Our dissenting colleagues point to no evidence which would indicate *that respondent* [*union*] *was* insincere in its statements that it was not seeking *to negotiate with Riggs.* They merely assert, as they have elsewhere, [citing another case] that picketing to compel a change in wages and working conditions 'necessarily' is for the purpose of recognition and bargaining. *This is stated as virtually a proposition of law.* There is no judicial or legislative support for any such proposition. If Congress had intended to ban all picketing after thirty days, which is substantially what the dissenting view would accomplish, it could have achieved that objective in straight-forward and simple language. We hold, therefore, as did the Trial Examiner, that the picketing on the evidence in this case did not have for an object recognition or bargaining." (Emphasis supplied).

Here, as in *Keith Riggs,* the Union "has a legitimate interest apart from organization or recognition that [unorganized] employers meet prevailing pay scales

and employee benefits, for otherwise employers paying less than the prevailing wage scale would ultimately undermine the area standards."

The Union interest in avoiding the undermining of area standards is two-fold:

1. The threat to Union standards is created not only "by unorganized employers who pay less for labor" by a "cost package" test, but by unorganized employers who fail to provide *specific* benefits for their employees.

2. Unions have a legitimate interest in maintaining specific wage *and* benefit levels in unorganized shops and plants *wholly apart from the affect of such standards on Union relations with organized employers.* Evidence of such altruistic interest is frequently seen, as for example, in the consistent support of Unions for minimum wage laws.

Here the record is utterly devoid of evidence of Union insincerity in its statement that it was not seeking to negotiate with the Company. It was the Company which approached the Union with the question of what it would take to call off the picket line. It was the Company which sought to bargain on "area standards." The Union did no more than define area standards according to its best understanding of the same *and in general terms.* At no time did the Company indicate its willingness to come even part way by paying the *wage part* of such standards. At no time *then or thereafter* did the Company make any attempt to meet area standards *according to any interpretation of what area standards were in fact*, nor did it at any time provide its own definition of area standards.

The meeting of February 1, 1966 was a setup planned by Frame. The Company had no intention then or thereafter of meeting area standards, but only an intention to place the Union in a position of appearing to commit an unfair labor practice. Frame's plan was to demand the Union definition of "area standards." If Schwartz were flexible, Frame would then charge the Union with bargaining; if Schwartz were inflexible, Frame would similarly charge the Union with bargaining (*i.e.*, demanding recognition) *which is exactly what Frame did two days following the February 1 meeting as the initial step in this proceeding.*

The Trial Examiner frankly acknowledged that the *only* evidence upon which a Section 8(b)(7)(C) finding a violation could rest was the "presenting an employer with a demand that it cannot reasonably meet and still stay in business, and placing this in a context where the most practical alternative is the adoption of a Union contract." Thus, the Trial Examiner reasoned that since the cost to the Company of complying with area standards would be either prohibitive, or would suggest to the Company that signing a contract would be a more practical alternative, that knowing all this tainted the Union demand for compliance with area standards as a bad faith demand.

In other words, a Union can request an employer to raise its wage rates and employee benefits to area levels only if it is practical and convenient for the employer to do so! The real sense of the Board decision is that in defining area standards in terms of actual benefits, a Union acts at its peril, in that *it will be found to have demanded recognition if the Employer finds it impractical to pay equivalent benefits.*

The Board insists on the testing of area standards by an "equivalent costs" test despite the fact that the Company never came up with equivalent costs, or indicated in any way its willingness to do so. It is submitted that whatever may be the proper test for area standards, that it is not the test of equivalent costs. The housewife who buys a pot roast in a market is interested in (and makes comparison to) the cost "to her," not in the wholesale cost to the store, concerning which cost she has no interest at all. Similarly, area standards are measured by the level of *received* wages and benefits and not by the cost of the same to the employer.[3] Whether or not the employer can afford to meet area standards can be of no consequence whatsoever with respect to the Union's right to peacefully picket in seeking compliance therewith.

The single issue presented in this case is well pointed up by the Board in its Brief at page 15 where it states:

> "We submit that where a Union is not content with *equalizing labor cost* but requires adoption of details identical with Union contracts, a recognitional objective is established, and no further showing need be made." (Emphasis supplied).

Thus, it is the contention of the Board that by its very nature the Union definition of area standards, *to include specific benefits as well as specific wages,* is a demand for recognition. In the Board's own words (in *Keith Riggs, supra*) such "is stated as virtually a proposition of law."

---

[3]The term "area standards" is actually self definitive, *i.e.,* the wage rates and benefits being *received* in the area, not the cost to the Employers of providing the same.

As a proposition of law it is untenable. In the first place, it is unsound because of the context in which the Union demand arose. The Union, when asked what it meant by Union standards, quite naturally pointed to an area Union contract after striking the clauses which plainly involved recognition, bargaining or dealings with the Union.[4] In the second place, it is only "recognitional picketing" which may violate Section 8(b)(7)-(C) of the Act. In question here is the *purpose* of the picketing. The Board may not properly say, as it says here, whatever your purpose in fact, we find *as a matter of law,* a purpose of demanding recognition.

At page 16 of its Brief the Board makes this remarkable statement:

> "While the chief Union spokesman now testifies that he was not attempting to strike out all clauses which were not to be applicable to the Company, this fact was not communicated at the meeting and, indeed, no affirmative effort was ever made to make it clear to the Company that adherence to them was not required as the price for removing the pickets."

The short answer to this contention is that since the Company at no point ever intended to comply with area standards by *any* definition of the same, it was an academic question as far as the Company was concerned as to the exact specifics of area standards. The Company had served its purpose in obtaining an inflexible (non-bargaining) position from the Union and two days later it filed these charges based upon such position.

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[4]Had the Union been more specific than this in its "demands" Frame would certainly have argued that such specificity was in fact bargaining.

But it is crucial to note that the Union position, while inflexible *as to any bargaining,* was not inflexible *as to what the area standards might be in fact.* Frame never asked Schwartz to be more specific concerning or to reconsider what the area standards *were* or even to discuss the same; but only "are any of these things . . . negotiable?" [R. 36; Tr. 18]. Schwartz properly replied, "Nothing is negotiable [i.e., you must comply with the area standards]." (*Ibid.*)

The line between area standards and benefits which may be sought only as the result of recognition and bargaining is easy to draw. To the left lie wages and benefits payable directly to employees; to the right lie all provisions of an agreement which cover the relationships between Union and Employer.

Where, as here, there is no substantial evidence (indeed, no evidence at all) to indicate that the picketing was "recognitional" in character, such cases as *NLRB v. Carpenters Local 2133,* 356 F. 2d 464 (C.A. 9, 1966) relied upon by the Board (Board Brief, p. 9) are inapplicable.

Conclusion.

For the reasons stated, the Board's order should be denied enforcement.

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Jerome Smith,
Kenneth M. Schwartz,
Robert M. Dohrmann,
Attorneys for Retail Clerk's Union Local 899, AFL-CIO.

Dated: June 7th, 1968.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JEROME SMITH

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Respondents.

INTERVENOR'S REPLY BRIEF

PRELIMINARY STATEMENT

Respondents appear to make five principal points in their briefs.

Respondents contend:

1. The Board has held that picketing aimed at requiring unorganized employers to adopt the specific benefits contained in area contracts is permissible area standards picketing.

2. Unions have a legitimate interest in requiring unorganized employers to adopt the specific benefits contained in area contracts.

3. What the Board's decision in this case amounts to is that a Union can request an employer to raise its wage rates and employee benefits to area levels only if it is practical and convenient for the employer to do so.

4. The meeting of February 1, 1966, "was a setup" planned by Intervenor's counsel.

5. Intervenor is somehow at fault for not disagreeing with the Unions' definition of area standards.

Respondents' contentions will be answered in the order they have been set forth.

ARGUMENT

The Board has not held that picketing aimed at requiring unorganized employers to adopt the specific benefits contained in area contracts is permissible area standards picketing. What the Board *has* held is that unions may seek to compel unorganized employers to incur costs equal to those of organized employers. Thereby, unorganized employers will be precluded from obtaining a competitive advantage over organized employers. The job security of union members will be protected. See *e. g., International Hod Carriers, etc. (Texarkana Construction Co.)*, 138 NLRB 10 (1962).

Respondents' reliance on *Local 741, United Assn. of Journeymen, etc. (Keith Riggs Plumbing and*

Heating Contractor), 137 NLRB 125 (1962), is misplaced. As pointed out in Intervenor's opening brief (page 11), all the union sought in *Riggs* was payment of prevailing wages.

The Board recognized in *Riggs* that "if a union pickets and says to an employer, 'We only want you to pay the prevailing wage scale, but don't want to bargain with you or organize your employees,' and there is no independent evidence to controvert this statement of objective, the Board cannot find that the picketing has organization, recognition or bargaining objectives . . .". There is no quarrel with that. However, in this case Respondents went considerably beyond that.

Where a union seeks to impose on an unorganized employer the identical employment terms and benefits of the union's area contract, then *pro tanto* it is engaged in bargaining.

This is particularly true if what are sought to be imposed are not only present terms and benefits, but future ones as well.

The distinction is pointed up by *Centralia Bldg. & Trades Council v. NLRB*, 363 F.2d 699 (D. C. Cir. 1967). If Intervenor had acceded to Respondents' demands, just as in *Centralia* "very little would (have been) left in the field of collective bargaining" to a representative chosen by its employees.

Both *Riggs* and *Centralia* affirm the decision of a Trial Examiner. The Trial Examiner was William E. Spencer in both cases.

McLeod v. Chefs, Cooks & Pastry Cooks, Local 89 (Stork Club), 280 F.2d 760 (2d Cir. 1960), also cited by Respondents, has to do with the proviso to Section 8(b)(7)(c) of the Act (National Labor Relations Act, 29 U.S.C. Secs. 151 et seq.) permitting informational picketing if deliveries are not interfered with. It is not in point here.

Whether unions have a legitimate interest in requiring unorganized employers to adopt the specific benefits contained in area contracts, is simply another way of stating the same problem. A key point Respondents overlook is that the employees of an unorganized employer might prefer other benefits instead. Instead of *receiving* (Respondents' emphasis) 50¢ per hour more wages and 20¢ per hour more fringe benefits, those employees might prefer 70¢ per hour more wages and no more fringe benefits.

The Board's decision in this case is not that a Union can request an employer to raise its wage rates and employee benefits to area levels only if it is practical and convenient for the employer to do so. There is nothing in the decision to preclude a union from compelling an unorganized employer to incur costs which equal those incurred by organized employers, no matter how hard it hurts.

The Board's decision recognizes, however, that *vis-a-vis* Respondents' request for identical specific benefits, Intervenor was faced with an economically impossible demand. The Trial Examiner on page 13, lines 10-14, of his decision, put it this way, "One need not resort to speculation to conclude that the

comparative cost of equivalent benefits to an individual employer as contrasted with costs to a contract employer under group plans or trusts covering the entire Southern California food industry would necessarily be so greater that it would present a virtual economic impossibility".

In other words, it was not a matter of Intervenor meeting the costs of organized employers. Intervenor was called on to incur *more* costs than organized employers, putting *it* at a competitive disadvantage, one that could be relieved only by signing Respondents' area contracts.

To this is added the practical impossibility of Intervenor providing portability of pension credits.

Meat Cutters' counsel argues that its area contract does not provide for portability. The argument must be made with tongue in cheek.

Portability is provided for in Article I, Sections 1, 2 and 3, of the Declaration of Trust which begins on page 30 of the Meat Cutters' industry agreement (G. C. Exh. No. 3) and in the September 29, 1958, amendment which appears on page 39 of the industry agreement. The provisions on page 30 of the agreement make it clear that the pension plan embraces all signatory employers and their employees within all the areas of the specified Meat Cutters' locals. The amendment on page 39 provides for reciprocal arrangements with Meat Cutters' retirement plans in other areas of California. Because of the statewide reciprocity, the Meat Cutters' agreement in fact af-

fords more portability than does the Retail Clerks' agreement.

Respondents' contention that the February 1, 1966, meeting "was a setup" planned by Intervenor's counsel, must also be made with tongue in cheek. The contention was not made before the Trial Examiner or before the Board. There is nothing in the record to support it. In fact, *Respondents* suggested the meeting and made the arrangements for it. (Tr. 14, 150-151).

Respondents' further contention, that Intervenor is somehow at fault for not disagreeing with the Unions' definition of area standards, is if possible, even more bizarre. A fair summary of the evidence is that Intervenor asked what the standards were, Respondents told Intervenor that the standards were what the area contracts provided for, that the standards could not be modified, and that was it. Respondent Meat Cutters say ". . . the contracts spoke for themselves . . ." (Meat Cutters' brief, page 4). How or why in this circumstance Intervenor was supposed to disagree with Respondents' definition, escapes the writer.

Respondent Meat Cutters' statement that the contracts spoke for themselves in defining benefits belies Respondents' concurrent argument that Intervenor "could (not) reasonably have believed" (Meat Cutters' brief, page 9) that the detailed contract provisions not stricken concerning discharge procedures, seniority, times of store meetings so as not to conflict with union meetings, visits of union representatives

to the stores, discharge of expelled union members, and grievances and arbitration, were being sought.

CONCLUSION

Respondents' arguments amount to little more than an attempt to persuade the court that finding of fact made by the Board on substantial evidence are wrong in the sense that the Board should have resolved conflicts or drawn inferences other than it did. Cf., *NLRB v. Butchers Union, Local 120,* .... F.2d .... (9th Cir., Feb. 21, 1968, No. 21,742). Respondents present no sound reason why enforcement of the Board's decision should not be granted.

Dated, Coalinga, California,
July 5, 1968.

FRAME & COURTNEY,
TED R. FRAME,
Attorneys for Intervenor
State-Mart, Inc.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

TED R. FRAME,
Attorney for Intervenor.

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH DISTRICT

No. 22,516

WILLIAM A. PORTER, *Appellant*

vs.

W. FRANCIS WILSON AND PAULINE WILSON,
Husband and Wife, and
RICHARD A. WILSON AND SHARON L. WILSON,
Husband and Wife, *Appellees*

Brief for Appellant

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IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

WILLIAM A. PORTER Appellant VS. W. FRANCIS WILSON AND PAULINE WILSON, Husband and Wife, and RICHARD A. WILSON AND SHARON L. WILSON, Husband and Wife Appellees	NO. 22,516

STATEMENT OF JURISDICTION

The Court of Appeals for the Ninth Circuit has jurisdiction of this case pursuant to 28 U.S.C.A., Section 1291, on an Appeal of a final decision by the District Court for the District of Arizona, Phoenix Division and pursuant to 28 U.S.C.A., Section 1294, as an appeal to the Court of Appeals for the Ninth Circuit encompassing the District of Arizona, on the action of the District Court of Arizona in granting Appellees' Motion to Dismiss which was a final, appealable decision of the District Court of Arizona to this Court.

Respectfully submitted,

HOOPER, STEVES & KERRY
200 Fort Worth Club Building
Fort Worth, Texas 76102

By: ______________________
Sterling W. Steves

ATTORNEYS FOR APPELLANT

I certify that on the 11th day of March, 1968, I sent, by certified mail, three copies of the above Statement of Jurisdiction to the attorney for Appellees, the Honorable Richard A. Wilson, at his last known address which was at the offices of Lutich, D'Angelo & Wilson, 3120 North Third Avenue, Phoenix, Arizona.

____
STERLING W. STEVES

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IN THE

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RICHARD A. WILSON AND SHARON L. WILSON,
Husband and Wife, *Appellees*

Brief for Appellant

STATEMENT OF JURISDICTION

The District Court had jurisdiction of this case as a diversity action between citizens of different states involving a controversy in excess of $10,000 exclusive of interest pursuant to 28 U.S.C.A. 1332(a). (Complaint, TR. 1-3.)

STATEMENT OF THE CASE

In 1961 Pearline Porter, Pauline P. Leonard and William A. Porter doing business as the Continental Hotels System, a co-partnership, instituted suit in this cause against W. Francis Wilson and Pauline Wilson, his wife, and Richard A. Wilson and Sharon L. Wilson his wife, to quiet title to real property in Phoenix, Maricopa County, Arizona. The property is known as the "Arizona Hotel" and is located in downtown Phoenix.

The Plaintiffs (only one, William A. Porter, is the Appellant in this appeal) asserted fee title through a deed from Mrs. Gladys Porter, the former wife of William A. Porter, through a conveyance allegedly made by Mrs. Gladys Porter to the Defendants Wilson.

The Defendant answered and admitted they claimed an interest in the Arizona Hotel and alleged that Gladys Porter acquired the interest of William A. Porter by sale of execution on execution on the 20th day of August, 1959 and that Defendants acquired their ½ interest in said property by deed from Gladys Porter on May 4, 1960. Defendants asserted they had good title to the property by said deed. Defendants also asserted that the federal district court did not have jurisdiction because of a prior case, Cause No. 55179, pending in the Superior Court of Maricopa County, Arizona.

Both the Plaintiffs and the Defendants moved for summary judgment on the grounds that prior actions were res judicata.

BACKGROUND OF PRIOR ACTIONS IN ARIZONA

William A. Porter and Gladys were residents of Kootenai County, Idaho. They had been married in 1940 in Detroit, Michigan. In 1943, Gladys and Arnold, as he is known, and Pearline and Pauline, his sisters, formed a partnership concerning the operation of the hotels owned by the parties. In August 1943 a deed was executed conveying title to the Ari-

zona Hotel to Gladys and Arnold (no mention was made of any interest of the Porter sisters).

In December 1958, Gladys left Idaho and after a short visit in California came to Phoenix and in February 1959, instituted a Complaint for Separate Maintenance, alleging Arnold was a resident of Arizona. She also alleged the hotel was community property. An attachment was issued which was levied upon the Arizona Hotel. The Porter sisters intervened in the Maricopa County action alleging the hotel was partnership property and that the sisters owned a ⅓ interest total therein. Gladys petitioned for a receiver and she also filed a counterclaim against the Porter sisters as intervenors. A receiver was appointed to run the hotel and later, on May 14, 1959, a decree of separate maintenance in favor of Gladys against Arnold was granted. Arnold never appeared in the separate maintenance action and was never personally served.

IDAHO

On May 25, 1959, Arnold filed a complaint for divorce against Gladys in the 8th Judicial District Court, County of Kootenai, Idaho. (Tr. 16-26) Gladys personally appeared, answered and filed a cross action for a divorce. (Tr. 27-51).

Back in Arizona, the Maricopa County Superior Court ordered the Receiver of the Arizona Hotel to pay Gladys $1,000 per month for her support and that of the minor children of the parties.

A Writ of Execution was issued in Maricopa

County and in August, 1959, Gladys purchased the hotel from the Sheriff. The Sheriff's deed conveying the Arizona Hotel property was given to Gladys.

Back in Idaho, the Porter sisters intervened. All parties were before the Idaho Court in personam.

On May 4, 1960, during the trial of the Idaho case before the Court, Gladys executed the deed to the Wilsons conveying to them an undivided ½ interest in the Arizona Hotel.

On December 28, 1960, the findings of fact and conclusions of law of the Idaho divorce decree were entered. (Tr. 53-64, 66-74). Gladys was awarded the bulk of the community property. The Idaho Court found the Arizona Hotel was partnership property and required Gladys to convey her interest in the Arizona Hotel to Arnold and the sisters. Gladys appealed that portion of the decree to the Idaho Supreme Court. The Idaho Supreme Court upheld the Idaho divorce decree in *Porter v. Porter*, 84 Idaho 400, 373 Pac. 2d 327 (1962).

BACK IN ARIZONA

In Arizona, the Porter sisters filed a Supplemental Complaint in Intervention and prayed that full faith and credit be given to the prior Idaho judgment.

The Arizona separate maintenance action was tried before a jury on December 18, 1961. At the trial only documentary evidence was introduced but it was rejected upon Gladys' objection. (Tr. 53-64, 66-74). The deeds from Gladys to Arnold and the

two Porter sisters were received in evidence, as well as a release of the Arizona decree of seperate maintenance entered by the Maricopa County Superior Court on May 14, 1959. A directed verdict was entered by the Court in Gladys' favor.

A judgment was entered that the sisters take nothing and that Gladys recover her costs. The trial court was reversed by the Arizona Court of Appeals, Division One, which was itself reversed by the Arizona Supreme Court in a split decision. *Porter v. Porter*, 101 Ariz. 131, 416 Pac. 2d 564, cert denied.

The Defendants' Motion for Summary Judgment was predicated on the theory that the opinion of the Arizona Supreme Court in *Porter v. Porter* was res judicata. (Tr. 78).

The Plaintiffs claim that the prior judgment of the Idaho Supreme Court was res judicata (Tr. 77) under the doctrine of *Treinies v. Sunshine Mining Co.*, 308 U.S. 66, 84 L.Ed. 85 (Tr. 7-15).

The Defendants' Motion for Summary Judgment or to dismiss for failure to state a claim was set for hearing before the federal court in Phoenix on June 12, 1967. Appellant, William A. Porter's counsel, Sterling W. Steves, moved for a continuance on the grounds that he was already under orders of the VIII United States Army Corps to report on June 10, 1967 to Fort Chaffee, Arkansas for two weeks of active duty. (Tr. 83, Affidavit Tr. 84-86). Counsel for the sisters, Mr. Paul Beer, was present at the hearing on June 12, 1967.

The Motion for Continuance was denied and the Defendants' Motion for Summary Judgment came on. The Court dismissed the Complaint for the reason that there was no issue to try. (Tr. 87).

Appellant moved for a new trial on the grounds, inter alia, of failing to grant the Motion for a Continuance, (Tr. 89) and failure to give full faith and credit to the Idaho decree. The Court denied the Motion on the ground the Court was required to follow the conflict of law rules promulgated by the Supreme Court of Arizona. (Tr. 91).

This Appeal followed.

The Arizona Hotel property has now been sold by the Wilsons and Gladys to the City of Phoenix. (Tr. 99).

SPECIFICATION OF ERRORS

POINT OF ERROR I

The Trial Court erred in failing to grant Appellant's Motion for a Continuance.

POINT OF ERROR II

The Trial Court erred in failing to resolve a conflict between court decisions in different states by applying the Constitutional Principles of "Full Faith and Credit."

POINT OF ERROR III

The Trial Court erred in holding that the Idaho judgment is not entitled to Full Faith and Credit and is res judicata as to each and every ground, jurisdictional and otherwise.

POINT OF ERROR I (Restated)

The Trial Court erred in failing to grant Appellant's Motion for a Continuance.

This case had been pending for approximately 6 years on the docket of the federal court in Phoenix. The Defendants filed their Motion for Summary Judgment in April, 1967. The Court set the Motion down for hearing on June 12, 1967. A change in Appellant's Counsel occurred in late May, 1967.

Appellant's lead counsel became Sterling W. Steves. The case had originally been set for argument at an earlier time and then, on the court's motion, changed

to June 12, 1967. A Motion for Continuance was immediately filed on the grounds counsel had been previously ordered by VIII United States Army Corps to report to Fort Chaffee, Arkansas, on June 10, 1967. (Tr. 84-86) The Motion was denied and the hearing held anyway, with the result that Defendant's Motion to Dismiss was granted, *with prejudice.*

It is respectfully urged that the lower court erred in denying the Motion for Continuance in such circumstances.

No injury would have been sustained to any party by granting such Motion and the circumstances were clearly beyond counsel's control.

Had any party been in the military service, a continuance would have been in order pursuant to 50 U.S.C.A. Sect. 521. Why not grant such a Motion when Counsel cannot be present? The failure to grant such Motion for Continuance deprived William A. Porter the right of counsel to be heard at the time the Court dismissed his case. It is submitted without belaboring the point, the trial court abused his discretion. *Velvestad v. Flynn*, 230 F. 2d 695 (CA 9th, 1956); *Ockert v. Union Barge Line Corp.*, 190 F.2d 303 (CA 3rd, 1951), 15 Fed. R. Service, 41a.22, case 2; *Merrit Chapman & Scott v. Kent*, 309 F.2d 891 (6th Cir., 1962) cert dismissed 83 S. Ct. 1118; 17 *C.J.S.* "Continuances", Sect. 37.

POINT OF ERROR II (Restated)

The Trial Court erred in failing to resolve a conflict between court decisions in different states by applying the Constitutional Principles of "Full Faith and Credit."

The resolution of such a conflict, as in this case, must evolve from a consideration of the constitutional principles underlying federalism and not from a mere preference for the state in which the forum Federal Court happens to be located. A Federal District Court faced with a conflict between state courts must base its decision upon the constitutional and statutory requirements of federalism, namely full faith and credit. Regrettably without any discussion of its rationale, the District Court below chose to give preference to the decision of the Arizona Supreme Court over a decision of the Idaho Supreme Court.

The Constitution of the United States requires each state to give full faith and credit to the judicial proceedings of every other state. Article IV, Section 1 of the Constitution of the United States provides as follows:

> "Full Faith and Credit shall be given in each state to the public Acts, Records, and judicial proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof."

The Congress of the United States specifically directed Federal Courts to enforce the judicial proceed-

ings of another state in the state in which that Federal Court resides. The pertinent portions of 28 *U.S.C.A.*, Section 1738, provide:

> ". . . judicial proceedings . . . shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken . . ."

This statute directs that if the principles of full faith and credit require that the Idaho judgment be enforced in Arizona, then the lower Federal Court must enforce that judgment regardless of any decision by the Arizona Supreme Court.

The Supreme Court in *Treinies v. Sunshine Mining Co.*, 308 U.S. 66 (1940), confirmed a decision of the 9th Circuit wherein that court resolved inconsistent state judgments as to the ownership of Sunshine stock. A Superior Court in Washington State adjudged in a probate action that the stocks were the property of John Pelkes. A District Court in Idaho held that the same property belonged to Katherine Mason. Because of the conflict of the judgments, the Sunshine Mining Company filed an interpleader action in the Federal District Court of Idaho to determine which of the parties should receive the stock and dividends.

Although the Supreme Court eventually declared the Idaho District Court's decision as paramount over the Washington State decision, they did not predicate such action on the ground that an Idaho Federal

Court is bound, in resolving such a conflict, to the decision of an Idaho Court. The relevant consideration is the "full faith and credit" clause of the Constitution:

> ". . . on account of conflict between the judgments of the respective court's of sister states and the assertion of the failure to give full faith and credit to both in the interpleader action, we grant certiorari." 308 U.S. at 68.

In *Durlacher v. Durlacher*, 123 F.2d 70 (9th Cir. 1941), the 9th Circuit resolved a conflict between the States of New York and Nevada. Mrs. Durlacher first obtained a support order from a New York Court. She was then divorced by her husband in Nevada. After the divorce the New York Court gave her three maintenance judgments, on which she sought execution in the Federal District Court in Nevada. Mr. Durlacher maintained that the Federal District Court should apply the law of Nevada since it resided in Nevada. The 9th Circuit rejected this view at page 72:

> "Simon contends, however, that such faith and credit should not be given it since the present suit was instituted in Nevada and the Nevada United States District Court was bound to apply the law of the State of Nevada. The Nevada law is claimed to be that, upon the dissolution of the marital tie, the Court in which the prior maintenance proceeding was pending lost jurisdiction to render a judgment for maintenance sums. Cf. Herrick v. Herrick, 55 Nev. 59, 25 P.2d 378. That is to say, the Nevada Federal Court could refuse to recognize the New York judgment because

repugnant to Nevada law.

> "The Supreme Court has repeatedly held that under the full faith and credit clause of the constitution (extended by the Statute to the Court below), a judgment of a sister state must be enforced, even though the cause of action upon which the judgment is based is repugnant to the law of the state requested to enforce it . . . (Citations)

The 9th Circuit affirmed the *Durlacher* opinion in *Bassett v. Bassett*, 141 F.2d 954 (9th Cir. 1944). Once again the wife received a separate maintenance order from the New York Courts. The husband received a divorce in Nevada which purported to release him from the New York maintenance order. The wife received New York judgments for maintenance payments accrued subsequent to the Nevada divorce. The Federal District Court in Nevada had to resolve the conflicting state decrees concerning the enforcibility of a New York maintenance decree after a Nevada divorce.

Once again the Nevada Federal District Court was directed by the 9th Circuit to resolve the conflict by full faith and credit, and not by local state loyalty. The 9th Circuit held that full faith and credit required that the New York decree be enforced.

> "In the case of *Durlacher v. Durlacher*, 9th Cir., 123 F2d 70, we reviewed the procedure of the New York Court in circumstances substantially identical to those herein and held that since the judgment entered in the New York Court was in all respects a valid judgment, it could not be

set aside or affected by a judgment of a court of another state . . ." 141 F2d at 955.

The relevant consideration for this court, then, is whether the Idaho decree is entitled to full faith and credit in the Federal District Court in Arizona.

POINT OF ERROR III (Restated)

The Trial Court erred in holding that the Idaho judgment is not entitled to Full Faith and Credit and is res judicata as to each and every ground, jurisdictional and otherwise.

Gladys Porter appeared personally and by counsel in the Idaho proceeding and participated therein, indeed to the extent of counterclaiming for and obtaining a divorce in her favor. Not only did she not contest the jurisdiction of the court over the hotel property, she herself alleged it to be community property and prayed for a division thereof. Nor did she raise any other objection going to the jurisdiction of that court to entertain the divorce action. The only portion of the trial court's decision that she appealed to the Idaho Supreme Court was the order enjoining her from instituting or maintaining any Arizona action against her former husband or intervenors affecting the Arizona Hotel properties. The Idaho Supreme Court ordered the trial court to amend that portion of its decree. She did not appeal the division of property or any other portion of the divorce decree.

Gladys then returned to Arizona and attacked the

Idaho judgment as being invalid and not entitled to full faith and credit. In an opinion devoid of any mention of developed principles of res judicata and full faith and credit, a majority of that Court upheld her attack. Those constitutional principles, discussed immediately below, necessarily require the lower federal court to levy execution on the Idaho judgment.

Although the Full Faith and Credit Clause of the Constitution does not prevent one State's courts from allowing a party to collaterally attack an ex-parte sister-State judgment for lack of jurisdiction, *Williams v. North Carolina*, 325 U.S. 226, 65 S. Ct. 1092, 89 L.Ed. 1577 (1945), the rule is quite different when such an attack is made upon the other judgment when the complaining party appeared therein and participated in procuring the judgment. In the latter instance, as in the case at bar, the first judgment is entitled to full faith and credit, is res judicata as to all issues, including those of jurisdiction, and cannot be attacked collaterally where such an attack would not be allowed in the State of rendition. *Johnson v. Muelberger*, 340 U.S. 581, 587, 71 S.Ct. 474, 95 L.Ed. 552 (1951). In *Sherrer v. Sherrer*, 334 U.S. 343, 68 S.Ct. 1087, 92 L.Ed. 1429 (1948), which held that a foreign divorce decree could not, under these circumstances, be attacked for want of jurisdiction over the subject matter, the Supreme Court elaborated at length upon the controlling principles:

> "The requirements of full faith and credit bar a defendant from collaterally attacking a divorce decree on jurisdictional grounds in the courts of a sister-State where there has been participation

> by the defendant in the divorce proceedings, where the defendant has been accorded full opportunity to contest the jurisdictional issues, and where the decree is not susceptible to such collateral attack in the courts of the state which rendered the decree . . .
>
> "If respondent failed to take advantage of the opportunities afforded him the responsibility is his own. We do not believe that the dereliction of a defendant under such circumstances should be permitted to provide a basis for subsequent attack in the courts of a sister-State on a decree valid in the state in which it was rendered." 334 U.S. at 351-52.

The subsequent case of *Coe v. Coe*, 334 U.S. 378, 68 S.Ct. 1004, 92 L.Ed. 1451 (1948), applied the *Sherrer* rule where the defendant spouse appeared but failed to raise any objection to the jurisdiction of the court over the subject matter.

In order for the prior foreign decree to constitute res judicata, nothing more is required than that an opportunity be provided the defendant to contest the Court's jurisdiction. It matters not that he chooses not to do so or neglects to do so. *Cf. Chicot County Drainage District v. Baxter*, 308 U.S. 371, 60 S.Ct. 317, 84 L.Ed. 329 (1940). The foreign judgment is conclusive as to all issues that were or could have been litigated.

The Ninth Circuit articulated the rule that a foreign State's judgment may be collaterally attacked only if such judgment is subject to collateral attack in said foreign state in *Durlacher v. Durlacher*, 123

F.2d 70 (9th Cir. 1941). Mrs. Helen Durlacher obtained a separate maintenance decree in New York. Subsequently, Mr. Simon Durlacher obtained a divorce in Nevada. This action in turn was followed by a suit in New York by Mrs. Durlacher for support payments accrued since the Nevada divorce. Simon failed, in the New York Court, to raise the question of New York's jurisdiction after the Nevada divorce. Under New York law, the failure to raise the jurisdictional issue at the trial, precluded collateral attack. Thus, when Mrs. Durlacher returned to the Nevada Federal Court, Mr. Durlacher was precluded from collaterally attacking the New York judgment. As the Ninth Circuit stated at page 71-72:

> "Nevertheless in New York Simon [Durlacher] could have brought a suit in which he would have been entitled to show that the court had lost jurisdiction in the maintenance proceeding. If successful he could have restrained Helen from procuring execution or suing on her New York judgment in the maintenance proceeding. However, he could not have prevailed in such a separate suit because the divorce decree he would have pleaded as causing the loss of jurisdiction in the maintenance proceeding was obtained without Helen's appearance therein or her presence in Nevada or her service within that state. New York holds invalid a divorce decree so obtained. Hence, in New York, Helen's maintenance judgment was secure from collateral attack and would be given full faith and credit in that jurisdiction."

The Ninth Circuit articulated this same position in

Bassett v. Bassett, 141 F.2d 954 (9th Cir. 1944), a case very similar to the one before this Court. Mrs. Bassett secured a separate maintenance order from the State of New York against her husband. Later Mr. Bassett received an absolute divorce in the State of Nevada. The Nevada decree purported to release the husband from any further support payments under the New York judgment. Later Mrs. Bassett sued and received a judgment in New York for support payments accrued since the divorce. As in this case, Mr. Bassett chose not to raise the first state's decree in the second state. Mrs. Bassett sued in the Nevada Federal District Court for execution on the New York judgments. That Court dismissed the action on the ground that the Nevada decree was res judicata. The Ninth Circuit reversed on the ground that since the New York Court possessed jurisdiction of the parties, the only place Mr. Bassett could attack the New York decree was in New York, as the Court stated at page 955:

> ". . . The State of New York had acquired jurisdiction over both parties to this appeal in the original separate maintenance action and, according to its law, retained jurisdiction throughout the proceedings leading to the two judgements questioned here. In those proceedings William Bassett could have appeared and pleaded any defense that he may have had, but this he failed to do. Had he appeared in the New York proceedings subsequent to the granting of the original decree and been unsuccessful, his recourse would have been in the Appellate Courts of New York and the Supreme Court of the United States.

> "As here presented we are asked to accept the decree of a Nevada State Court which, in effect, attempts to set aside decrees or judgments of a Court of New York. . . ."

As in *Bassett* and *Durlacher*, Gladys Porter was subject to the jurisdiction of an out of state court, in this case Idaho, and failed to raise the jurisdictional question. As in *Bassett* and *Durlacher* she later raised that question in the first State, in our case Arizona. The *Bassett* and *Durlacher* cases, conclusively establish that the original state must honor the second State's decree, regardless of what defenses could have been raised in the other state assuming, as here, that the decision is not subject to collateral attack in the first State.

One of the primary arguments of the majority opinion in the Arizona collateral attack is that the Idaho court did not have jurisdiction to directly affect Gladys' separate property in Arizona. There are two answers to this contention. First, since Gladys herself executed the deeds to the Arizona property, the Idaho court did not "directly affect" title to Arizona realty. *Kennedy v. Morrow*, 77 Ariz. 152, 268 P.2d 326 (1954). See *Fall v. Eastin*, 215 U.S. 1, 8, 11-12, 30 S. Ct. 3, 54 L.Ed. 65 (1909). Secondly, the Idaho court determined for itself from the parties' pleadings that it had jurisdiction to order Gladys to convey her interest in the property and it is now settled that the adjudication of facts affecting title to land located in another State becomes res judicata and is entitled to full faith and credit in the State in which the land is situated.

The United States Supreme Court has discussed the effect of an in personam judgment concerning real property in a case concerning land lying between Nebraska and Missouri. The Nebraska court litigated the matter and the losing party went to Missouri claiming the land was located in the State of Missouri. The United States Supreme Court in *Durfee v. Duke*, 175 U.S. 106, 84 S.Ct. 242, 11 L.Ed. 2d 186, (1963), stated:

> "With respect to questions of jurisdiction over the person, this principle was unambiguously established in Baldwin v. Iowa State Traveling Men's Assn., 283 522. There it was held that a federal court in Iowa must give binding effect to the judgment of a federal court in Missouri despite the claim that the original court did not have jurisdiction over the defendant's person, once it was shown to the court in Iowa that that question had been fully litigated in the Missouri forum. 'Public policy,' said the Court, 'dictates that there be an end of litigation; that those who have contested an issue shall be bound by the result of the contest, and that matters once tried shall be considered forever settled as between the parties. We see no reason why this doctrine should not apply in every case where one voluntarily appears, presents his case and is fully heard, and why he should not, in the absence of fraud, be thereafter concluded by the judgment of the tribunal to which he has submitted his cause.' " 283 U.S., at 525-526.
>
> "Following the Baldwin case, this Court soon made clear in a series of decisions that the general rule is no different when the claim is made that the original forum did not have jurisdiction

> over the subject matter. Davis v. Davis, 305 U.S. 32; Stoll v. Gottleib, 305 U.S. 165; Treinies v. Sunshine Mining Co., 308 U.S. 66; Sherrer v. Sherrer, 334 U.S. 343. In each of these cases the claim was made that a court, when asked to enforce the judgment of another forum, was free to re-try the question of that forum's jurisdiction over the subject matter. In each case this Court held that since the question of subject-matter jurisdiction had been fully litigated in the original forum, the issue could not be retried in the subsequent action between the parties." [Footnotes omitted]

The Court concluded by saying this rule of jurisdictional finality should apply to a case involving real property as between the parties to the litigation.

Relying upon recent constitutional precedent, the American Law Institute has addressed itself anew to this very problem. In *Restatement of the Law* (Second), *Conflict of Laws* (Tent. Draft No. 10) (1964), Sec. 430d, it is stated:

> "When a court has jurisdiction over the parties and determines that it has jurisdiction over the subject matter, the local law of the State where the judgment was rendered determines, subject to constitutional limitations, whether the parties are precluded from collaterally attacking the judgment on the ground that the court had no jurisdiction over the subject matter."

In Comment (c) to the above Section, the Institute concludes that:

> "Due process does not prevent a State from impinging on the interests of a sister-State by ap-

> plication of rule that parties who were subject to the jurisdiction of the court cannot collaterally attack the judgment for lack of jurisdiction over the subject matter."

Having participated fully in the Idaho proceedings, but having failed to claim jurisdictional error there, one must look to Idaho law in order to ascertain whether Gladys is entitled to collaterally attack its decree on the grounds invoked by the majority opinion. In *Treece v. Treece*, 84 Idaho 457, 373 P.2d 750 (1962), that court stated that a divorce decree regular upon its face could not be attacked collaterally by a party except on the ground of extrinsic fraud. Said judgments are held to be conclusive as between the parties on all issues determined or which should have been determined thereby. See also *Robinson v. Robinson*, 70 Idaho 122, 212 P.2d 1031 (1949). Having pleaded that the hotel property was community property, thereby giving that court jurisdiction to divide it, the judgment is regular upon its face. Neither Gladys nor the majority opinion in Arizona suggest that the proceedings there were had as a result of fraud. Thus, since Gladys could not collaterally attack the decree in Idaho, she cannot do so in Arizona.

Therefore, the Idaho divorce decree is res judicata on the questions of whether the hotel property is or was community property or her separate property and as to the validity of the trial court's order compelling her to convey her interests therein to the partners. Even if the Idaho court erred in refusing to enforce the accrued installments, and even if Gladys had indeed placed the facts of the Arizona

sheriff's sale before that court and the latter had erroneously refused to give such "proceedings" effect, the Idaho decree is nonetheless entitled to full faith and credit. Retaliation by the courts of Arizona is fundamentally inconsistent with notions of full faith and credit.

The United States Supreme Court has passed on just such a question on several occasions. The leading case is *Treinies v. Sunshine Mining Co.*, 308 U.S. 66, 60 S.Ct. 44, 84 L.Ed. 85 (1939). In *Treinies*, the Idaho court, with both parties before it, conferred title to certain personal property upon A, after first finding that a prior Washington judgment between the parties which awarded the property to B was not entitled to full faith and credit because of a jurisdictional defect. In a third action between A and B, B attempted to rely upon the original Washington decree. The United States Supreme Court held that B was not entitled to rely on the Washington judgment:

> " . . . because of the Idaho decision that the Washington probate court did not have exclusive jurisdiction. This is true even though the question of the Washington jurisdiction had been actually litigated and decided in favor of [B] in the Washington proceedings, the right to review that error was in those (the Idaho) proceedings. . . .
>
> "The power of the Idaho court to examine into the jurisdiction of the Washington court is beyond question. Even where the decision against the validity of the original judgment is erroneous, it is a valid exercise of judicial power by the second court.

> "One trial of an issue is enough. 'The principles of res judicata apply to questions of jurisdiction as well as to other issues,' as well to jurisdiction of the subject matter as of the parties." 308 U.S. at 76-78 (citations and footnotes omitted and emphasis added.)

Treinies is on all fours with the instant case and should control its disposition. Justice Udall acknowledged this in his Arizona dissent and the unanimous Court of Appeals in Arizona recognized that it was bound by the *Treinies* principle. *Porter v. Porter*, 101 Ariz. App. 363, 403 P.2d 298 (1965).

Subsequent Supreme Court decisions have adhered to the *Treinies* doctrine. In *Sutton v. Leib*, 342 U.S. 402, 72 S.Ct. 398 (1952), a federal court applying Illinois law in a diversity case was required to give full faith and credit to a New York Court's finding that impeached the jurisdiction of a Nevada ex parte divorce since the New York judgment was res judicata. The Court stated the New York "decree is entitled to full faith throughout the nation, in Nevada as well as in Illinois." In *Morris v. Jones*, 329 U.S. 545, 67 S.Ct. 451 (1947), the State of Illinois was required to give full faith and credit to a Missouri judgment which was subsequent to an Illinois court order staying all suits against an unincorporated insurance company. In *Roche v. McDonald*, 275 U.S. 449, 48 S.Ct. 143, 72 L.Ed. 365 (1928), a decision predating *Treinies*, the Court said:

> "If McDonald desired to rely upon the Washington statute as a protection from any judgment [in Oregon] . . . he should have set up that sta-

> tute in the court of Oregon and submitted to that court the question of its construction and effect. And even if this had been done, he could not thereafter have impeached the validity of the judgment because of a misapprehension of the Washington law. In short, the Oregon judgment, being valid and conclusive in the court of Washington, and under the full faith and credit clause should have been enforced by them." 275 U.S. at 455.

This position is consistent with current judicial trends. Modern-day federal and State court decisions recognize that the State whose earlier judgment was denied full faith and credit by a sister-State court cannot for that reason refuse to recognize and enforce as res judicata the out-of-State decree.

For example in *Southard v. Southard*, 305 F.2d 730 (2nd Cir. 1962) (Noted in 65 W.Va. L.Rev. 220), the court held that a divorce proceeding in Connecticut, which failed to give full faith and credit to a Nevada divorce, was valid. The only factor needed to be shown was that the Connecticut Court possessed jurisdiction. As the court said on page 732.

> "It is clear from the appellant's complaint that—as he admits in his brief on this appeal—he entered an appearance in the Connecticut divorce action the outcome of which he here seeks to attack. His person was thus under the jurisdiction of the Connecticut court, and there are no allegations which could support collateral attack on the judgment. Whether or not the appellant subsequently defaulted as to the further proceedings leading up to the judgment, and whether or not he was deprived of rights by errors of the

> Connecticut court, our determination that that court had jurisdiction over him and the case precludes any further attack on the judgment" Morris v. Jones, 329 U.S. 545, 67 S.Ct. 451, 91 L.Ed. 488 (1947).

In *Lewis v. Lewis*, 49 Cal.2d 389, 317 P.2d 987 (1957), the husband had obtained an ex parte divorce in Nevada but failed to set it up as a defense to an Illinois divorce action brought by the wife. Having obtained her Illinois divorce, she next sued the husband in California for accrued support payments. The husband then claimed that the Illinois decree was void for want of jurisdiction over the marriage because of the earlier Nevada decree. A unanimous California Supreme Court, per Traynor, J., stated:

> "The first answer to this contention is that it should have been invoked in the Illinois proceeding and that even if the Nevada decree had been pleaded as a defense in that proceeding and the Illinois court had erroneously failed to recognize it, defendant's remedy was by appeal and he cannot now attack the Illinois judgment." [citing *Treinies*, supra.] 49 Cal.2d at 393, 317 P.2d at 990.

The majority opinion in the Arizona Supreme Court states "full faith and credit clause does not compel us to overrule our decision by recognizing the Idaho judgment were we to concede its validity." Such a statement completely ignores the simple operation and effect of full faith and credit. For if the validity of the Idaho decree were to be conceded, then it becomes res judicata as between the parties thereto as

regards all the issues determined and all the issues that could have been determined therein. The *Restatement of the Law*, Judgments, Sec. 42, describes the effect of the second judgment on a prior inconsistent judgment:

> "Where in two successive actions between the same parties inconsistent judgments are rendered, the judgment in the second action is controlling in a third action between the parties."

Subsection (e) of Sec. 42 provides:

> "The rule stated in this Section is applicable not only where the actions are brought in the same State, but also where they are brought in different States."

(See Justice Udall's dissent, 101 Ariz. 131, 416 P.2d 564.

The *Restatement of the Law* (Second), *Conflict of Laws*, (Tant. Draft No. 10, 1964), provides:

> "Sec. 439a. Inconsistent judgments. A judgment will not be recognized or enforced in other States if an inconsistent, but valid judgment is subsequently rendered in another action between the parties and if the earlier judgment is superseded by the later judgment under the local law of the State where the later judgment is rendered."

Comment (a) to the above Section states that the rule is applicable even though the court that rendered the later judgment denied full faith and credit to the first judgment or made other errors of fact or law. Comment (e) notes that the rule is one of constitutional law as between the States. The State cases

cited by the majority in the Arizona Supreme Court for the proposition that the subsequent, valid out-of-State judgment does not supersede the prior Arizona determination on the same issue (*Colby v. Colby*, 78 Nev. 150, 369 P.2d 1019 (1962), cert. denied, 371 U.S. 888; *Perry v. Perry*, 51 Wash. 2d 538, 318 P.2d 968 (1958) and *Hammell v. Britton*, 19 Cal.2d 72, 119 P.2d 333 (1941) have been uniformly and roundly criticized as being inconsistent with principles of res judicata embodied in the Full Faith and Credit clause. See, e.g., Note, 31 *Geo. Wash. L. Rev.* 648 (1963); Note, 15 *Stan. L. Rev.* 331 (1963); Note, 16 *Vand. L. Rev.* 193 (1962). The California decision in that group, *Hammel v. Britton*, supra, should be viewed in light of the more recent opinion of that court discussed above, *Lewis v. Lewis*, supra, where the *Treinies* rule is invoked in a similar situation.

Finally, objections that the Idaho court had no jurisdiction to entertain the intervention action either because the Idaho rules of procedure did not permit the intervention action or because the partnership itself was not a party before the Court, are unavailable to Gladys for the same reason. Having participated in the action, the principles and authorities discussed above require that Gladys has presented her objections in that proceeding at that time. Having failed to do so, the judgment is res judicata on all questions of law, including jurisdiction to entertain Appellant Porters' intervention action. *Miliken v. Meyer*, 311 U.S. 457, 462, 61 S.Ct. 339, 85 L.Ed. 278 (1940).

CONCLUSION

For the reasons stated and discussed above, the Court should reverse the dismissal below and render judgment for Appellant.

Respectfully submitted,

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Attorneys for Appellant

Sterling W. Steves

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules. Dated at Fort Worth, Texas the........March, 1968.

Sterling W. Steves

No. 22516

In the

United States Court of Appeals

For the Ninth Circuit

WILLIAM A. PORTER

Appellant,

vs.

W. FRANCIS WILSON AND PAULINE WILSON, Husband and Wife, and RICHARD A. WILSON AND SHARON L. WILSON, Husband and Wife,

Appellees.

Upon Appeal from the District Court of the United States for the District of Arizona

APPELLEE'S BRIEF

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No. 22516

In the

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Attorneys for Appellees

BRIEF OF APPELLEES
STATEMENT OF THE CASE

The Statement of the case, as set forth by Appellant is to a large degree not pertinent to the present action.

The necessary facts are:

In 1959, a separate maintenance action was begun in the Superior Court of Arizona, in and for the County of Maricopa. Plaintiff was Gladys E. Porter. Defendant was William Arnold Porter. The Defendant failed to answer. In August, 1959, Gladys E. Porter, by Sheriff's Deed, acquired title to the real property here in question known as the Arizona Hotel. In May, 1960, Gladys E. Porter quit-claimed one-half of the property to Appellees, W. Francis Wilson and Richard A. Wilson. A full discussion of the facts of Porter v. Porter is set forth in the following cases, and it would serve no purpose to re-iterate them here should the Court determine they are pertinent:

Kemble v. Stanford, 86 Ariz. 392, 347 P.2d 28;

Porter v. Stanford, 86 Ariz. 402, 347 P.2d 35. cert. den. 371 U.S. 829, 83 S. Ct. 23, 9 L.Ed. 2d 66;

Kemble v. Porter, 88 Ariz. 417. 357 P 2d 155; and

Porter v. Porter, 1 Ariz. App. 363, 403 P2d 298, 101 Ariz. 131, 416 P2d 564, cert. den. 386 U.S. 957, 87 S. Ct. 1028, 18 L. Ed. 2d 107.

In 1961, the instant action was commenced by Continental Hotels System, an alleged co-partnership against Appellees. All parties, by Stipulation filed September 11, 1964, agreed that the outcome of the instant case would be determined or controlled by the final decision in *Porter v. Porter*, supra, (Tr 103). After the opinion in *Porter v. Porter*, supra, the Appellees moved for Summary Judgment, or in the alternative, to Dismiss (Tr 78). The matter was set for the 22nd day of May, 1967 (T.R. 103) and then continued pursuant to stipulation to the 12th day of June, 1967 (T.R. 103), at which time Mr. Paul Beer was present for Plaintiffs (T.R. 103), and at which time the lower Court

heard the matter and granted Defendants' Motion to Dismiss (T.R. 103).

Thereafter, on June 13, 1967, Plaintiff's Motion for Continuance of the hearing on Defendants' Motion was filed (T.R. 83 and 104).

Thereafter, motions were made and appropriate judgment and orders entered, as reflected by the record, and this appeal followed.

THE MATTERS PRESENTED BY THIS APPEAL ARE MOOT, AND THE APPEAL SHOULD BE DISMISSED.

As noted in Appellant's brief and by letter dated November 2, 1963 (Tr. 99), the subject property has been sold by Appellees, along with GLADYS E. PORTER, to the City of Phoenix, and Appellees make no further claim to the property.

Since the Complaint herein seeks to have it determined that Appellees have no interest in the property, it would seem the issues are moot, and no purpose would be served by proceeding with this appeal.

Accordingly, Appellees respectfully move the Court to dismiss the appeal.

APPELLANT IS NOT A PROPER PARTY TO THIS APPEAL

The Appellant makes no representation to the Court that he brings this Appeal on behalf of the alleged partnership which was the plaintiff below.

The Motion for New Trial (T.R. 89-90), refers only to the rights of William A. Porter, and in paragraph III thereof refers to "the title of Plaintiff, William A. Porter," and again in paragraphs IV and V reference is made to the rights of William A. Porter. No mention is made of the alleged partnership which was the plaintiff.

Arizona is governed by the provisions of the *Uniform Partnership Act. Chapter 2, Title 29, Arizona Revised Statutes.*

The original theory of this action was that the subject property belonged to a partnership composed of these persons. *Sec. 29-225, A.R.S. 1956*, sets forth the rights of a partner in specific partnership property:

"Sec. 29-225. Nature of a partner's right in specific partnership property

A. A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

B. The incidents of this tenancy are such that:

1. A partner, subject to the provisions of this chapter and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.

2. A partner's right in specific partnership property is not assignable except in connection with the assignment of rights of all the partners in the same property.

3. A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws.

4. On the death of a partner his right in specific partnership property vests in the surviving partner or partners except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners or the legal representative of the last surviving partner, has no right to possess the partnership property for any but a partnership purpose.

5. A partner's right in specific partnership property is not subject to dower, courtesy, or allowances to widows, heirs, or next of kin."

Under this statute, William A. Porter has no individual right in this property, and since no representation is made that he

brings this appeal on behalf of the alleged partnership as a partner. the partnership must be deemed to have accepted the judgment of the lower court and he is not properly before this court and the appeal should be dismissed.

REPLY TO POINT OF ERROR I

The statement made on Page 8 of Appellant's brief referring to Plaintiff's Motion for Continuance,

"The motion was denied and the hearing held anyway . . ."

is pure fabrication.

The facts as shown by the record are as follows:

Defendants' Motion for Summary Judgment, or in the alternative to dismiss, was originally set for May 22, 1967, at the suggestion of Plaintiff's counsel; by stipulation, the matter was continued to June 12, 1967.

The hearing was had on June 12, 1967, at which time Mr. Paul Beer appeared for the Plaintiffs, argument was had, and Defendants' Motion was granted. (Tr. 103)

Plaintiff's motion for continuance was not received by the Clerk of the lower court until June 13, 1967, as reflected by the Clerk's stamp on the rupper right-hand corner thereof (Tr. 83), and was docketed the same day (Tr. 104). The Motion was, in fact, never ruled upon because it was moot. To claim that denial of a motion (which did not occur) by a trial judge is prejudicial when the same is not filed until the next day, is irresponsibility of the highest order.

There can be no question that even had the motion been denied under the facts, it could not have constituted an abuse of discretion.

REPLY TO POINTS OF ERROR II and III

APPELLANT HAS ABANDONED AND WAIVED HIS CLAIM UNDER THE IDAHO JUDGMENT

As noted heretofore, the complaint in this matter is one which lies in quiet title (T.R. 1-3).

The Appellant in his brief is apparently relying on Plaintiffs' Motion for Summary Judgment as his basis for attempting to raise the question of full faith and credit at this time. The Minute Entires of the Trial Court (T.R. 103 and 104) show that although the *Plaintiffs'* Motion for Summary Judgment was filed on the 8th day of November, 1965, it was never set for hearing, and that the only matter brought before the court was *Defendants'* Motion for Summary Judgment, or in the alternative, to dismiss (A & E 499 [1]).

Although this point is so basic that there seems to be little need for authority, and indeed little authority exists, what authority there is is to the effect that:

> "A motion may be waived or abandoned by failure to proceed with respect to it, or by proceeding before the determination of the motion in a manner inconsistent with the object of the motion (60 C.J.S. 42, Motions, sec. 42; *Brandes v. Illinois Protestant Children's Home, Inc.*, 179 N.E. 2d 425; *Harju v. Anderson*, 111 Or. 414, 225 Pac. 1100.

Further, the matter may not be considered on review, the Court in *Stinson v. Business Men's Accident Ass'n*, 43 F. 2d 312, set forth the applicable law when it said, at page 314,

> "It is a question of law, however, whether a judgment is sustained by any substantial evidence, but in order to present that question on appeal it must appear from the record that a request or motion was made, denied and excepted to, or some other like step was taken, which fairly presented that question to the trial court and secured its ruling thereon before the close of trial," (omitting authorities), See also *Brandes v. Illinois Protestant Children's Home, Inc.*, supra.

For these reasons there can have been no error committed by the trial court under either Point of Error II or III, since the matter was not presented.

FULL FAITH AND CREDIT NOT AN ISSUE

It appears from the pleadings filed by Appellant in this cause, and by Appellant's opening brief, that the position of Appellant has moved drastically from that of a simple quiet title action to that of an intricate---if obvious---attempt to relitigate the matters already fully litigated in the case of *Porter v. Porter*, 1966, 101 Ariz. 131, 416 P. 2d 564. As a matter of fact, Appellant's entire brief is strikingly similar to the dissenting opinion rendered in the Porter case.

The entire emphasis of the brief, both in approach and in citation of authorities, disregarding the first assignment of error, is directed toward the question of whether the trial court committed error in denying full faith and credit to a Decree of Divorce rendered in the State of Idaho. This question has been fully litigated by the Arizona State Courts, as appears from the citations set forth in Appellees' Statement of Facts. More important, the matter has been fully litigated by the Supreme Court of the United States. After the Arizona Supreme Court decision in *Porter v. Porter*, (supra). Appellant herein filed a Petition for Writ of Certiorari on the precise Federal question raised by Appellant in its brief in this case, to-wit: denial of full faith and credit by the Arizona Court to the Idaho divorce judgment, and on March 13, 1967, the United States Supreme Court denied certiorari *(386 U.S. 957, 87 S.Ct. 1028, 18 L.Ed. 107)*.

To trace the effect of the denial of the Writ of Certiorari by the United States Supreme Court upon the right of Appellant to entertain the instant action, we must first look at *Rule 19 of the Revised Rules of the Supreme Court of the United States* (formerly Rule 38, and before that Rule 35), which we quote in part below:

"Rule 19. Considerations governing review on certiorari.

1. A review on writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons therefor. The following, while neither controlling nor fully measuring the court's discretion, indicate the character of reasons which will be considered:

(a) Where a state court as decided a federal question of substance not theretofore determined by this court, or has decided it in a way probably not in accord with applicable decisions of this court . . ."

In the case of *Campbell River Mills Co. v. Chicago, M., St. P. and P. R. Co.*, D.C. Wash., 42 P.2d 775, the Plaintiff had sought and received an adjudication by the Department of Public Works in Washington that Plaintiff had been required by Defendant railway company to pay an excessive tariff rate. The Department found in favor of plaintiff, and through successive appeals brought by Defendant the judgment for plaintiff was affirmed by the highest court of the State of Washington. Thereupon, the defendant presented a petition for writ of certiorari to the United States Supreme Court, denying the jurisdiction of the Department of Public Works over the subject matter of the litigation as the federal question involved. Certiorari was denied. Thereafter, the Department of Public Works computed the overcharge, and when defendant did not pay, Plaintiff instituted an action in the State court thereon. Defendant removed the action to federal court, and after judgment was rendered against him, appealed, once more raising the question of lack of jurisdiction over the subject matter. In this connection, and in considering the effect of the denial of the Writ of Certiorari by the United States Supreme Court, the Appellate Court stated at Page 778:

"(8) While denial of certiorari is not viewed in the light final judgment upon the issue, it is the instant case most persuasive. While the granting or refusal of the petition for the writ adds or withholds no sanction to the decision, rule 38 (former rule 35) of the Revised Rules of the Supreme Court (28 USCA Sec. 354) says a review on writ of certiorari is not a matter of right, but of sound judicial discretion, and will be

granted only where there are especially important reasons therefor, such as *where a state court has decided a federal question not determined by the Supreme Court, or probably not in accord with the decisions of that court,* (emphasis supplied) or where there is a conflict of decisions of the same matter in the Courts of Appeals in the different circuits, or the Circuit Court has decided an important question of local law probably in conflict with legal decisions or the weight of authority, or a question of law which should be settled by the Supreme Court, or a federal question in conflict with applicable decisions of the Supreme Court, or departed from the usual course of judicial proceeding as to call for the exercise of the supervisory power. It is apparent that the federal question involved was before the Supreme Court upon the petition for writ, and the rule of court and the denial of the writ would appear to be conclusive. See discussion, 'certiorari denied,' *Stamey v. U.S.* (D.C.) 37 F. (2d) 188."

In the instant case, it is likewise apparent that the Federal question raised by Appellant in this appeal has been previously considered by the U.S. Supreme Court upon the petition for the writ of certiorari. Having received unfavorable results, Appellant now seeks to attack the Arizona judgment by these collateral proceedings.

The question presented in this appeal is not properly a question revolving around full faith and credit or the "concept of federalism", as stated by counsel for Appellant, but rather a question of the proper application of the doctrine of res adjudicata. Once again, quoting from the *Campbell* case, supra:

"The foundation of the doctrine of res judicata, or estoppel by judgment, is that both parties have had their day in court. *2 Black, Judgts. Secs. 500, 504.* The general principal was clearly expressed by Mr. Justice Harlan, speaking for this court in *Southern Pacific R. Co. v. United States,* 168 U.S. 1, 48, 18 S. Ct. 18, 27, 42 L.Ed. 355, 'that a right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies.' *United States v. Sakharam Ganesh Pandit* (C. C. A.) 15 F. (2d) 285, 286."

It is, therefore, Appellees' position that it is unnecessary to respond to the propositions of law presented by Appellant in his brief as relates to full faith and credit. In any event, these legal theories are no more than a reiteration of the dissenting opinion of Judge Udall in the *Porter v. Porter* case, supra, and the majority opinion in that case provides all rebuttal necessary to Appellant's position. Should this Honorable Court feel the question of full faith and credit raised by Appellant to be in fact a matter for this Court's consideration, which we submit it is not, the majority opinion in the Porter case (101 Ariz. 131, 416 P.2d 564) more clearly and succinctly states Appellees' position than counsel could hope to do.

This matter has been determined by the highest court of the State of Arizona and by the United States Supreme Court and is res adjudicata as to this Appellant and to Appellees who stand in privity to Gladys E. Porter.

We submit that the trial court was correct in its order denying the motion for new trial and the authorities citied therein.

This case comes squarely under the authority of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L.Ed. 1188, in which the Court said:

> "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State shall be declared by its Legislature in a Statute or by its highest court in a decision is not a matter of federal concern . . ."

We submit, the issue of full faith and credit no longer exists and the issues raised by Appellant have been fully litigated and are now res adjudicata. We shall respond to this issue no further.

CONCLUSION

For the reasons stated above, the Appellant's appeal should be dismissed, or, in the alternative, the judgment of the lower court affirmed, there being nothing before this Court upon which the judgment should be reversed, nor upon which judgment could be granted for Appellant.

Respectfully submitted,

LUTICH, D'ANGELO & WILSON

By: Richard A. Wilson
RICHARD A. WILSON

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated at Phoenix, Arizona, this 4th day of April 1968.

Richard A. Wilson
RICHARD A. WILSON

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 22,516

WILLIAM A. PORTER, *Appellant*

vs.

W. FRANCIS WILSON AND PAULINE WILSON,
Husband and Wife, and
RICHARD A. WILSON AND SHARON L. WILSON,
Husband and Wife, *Appellees*

Appellant's Reply Brief

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IN THE

UNITED STATES COURT OF APPEALS

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WILLIAM A. PORTER, *Appellant*

vs.

W. FRANCIS WILSON AND PAULINE WILSON,
Husband and Wife, and
RICHARD A. WILSON AND SHARON L. WILSON,
Husband and Wife, *Appellees*

Appellant's Reply Brief

Now comes William A. Porter, Appellant and files his Reply to the Brief of Appellees herein and would show the Court as follows:

REPLY TO APPELLEES' STATEMENT OF THE CASE

In Appellant's Statement of the case, Appellant attempted to set forth the nature of the litigation before this Court.

Appellees' Statement of the Case requires a short reply by Appellant.

(A) THE CLERK'S ENTRY IS NOT SUFFICIENT TO SHOW THE LANGUAGE AND EFFECT OF A STIPULATION.

The alleged stipulation between the parties alluded to in Appellees' Brief to the effect that the decision in

Porter v. Porter, 101 Ariz. 131, 416 P.2d 564 would control the outcome of this case (Appellees' Brief, p. 1) is not included in this record on appeal. Appellees did not designate said stipulation and order to be included in the appellate record in this case. Therefore, Appellees cannot now, by referring to the clerk's docket entry (Tr. 103) correct this omission. It would appear unlikely that all parties would *carte blanch* agree to be bound by an appeal then pending in another court. The customary procedure is to stay proceedings until after the other appeal or case is terminated, then proceed with the case before the Court. If Appellees proposed to present the stipulation to this Court, Appellees should have designated it in order for the Court to have it before it at this time.

POINT OF ERROR I

The Trial Court erred in failing to grant Appellant's Motion for a Continuance

Appellees contend that Appellant's argument pertaining to Appellant's Motion for Continuance of the hearing is "pure fabrication" (Brief, p. 4).

The record shows by certificate of service that Appellant's counsel mailed the Motion for Continuance to all parties on June 9, 1967, which was a Friday. (Tr. 83). Appellees make much of the fact that the clerk's file mark shows that it was not received until Tuesday, June 13, 1967. (Tr. 83). Appellant's counsel did not know when the Motion was filed by the Clerk for the reason that counsel reported to the sunny hills of Fort Chaffee, Arkansas, on June 10, 1967. The

order of dismissal with prejudice was not signed until June 14, 1967, and the matter was called to the Court's attention by the Motion for New Trial citing, *inter alia*, the denial of the Motion for Continuance as grounds for said Motion. (Tr. 89).

Mr. Paul Beer represented the sisters of Appellant at said hearing but Appellant was not represented at said hearing. The order of dismissal prepared by Appellees as shown (Tr. 87) was not submitted for approval by other counsel pursuant to the local rules of the Federal District Court for Arizona and the error of Mr. Beer's representation was compounded. As shown by the Complaint in this case, Appellant was represented by Hawkins & Miller of Coeur D'Alene, Idaho (Tr. 2 & 3) while Paul Beer represented Pearline Porter and Pauline P. Leonard. The old firm of Beer, Seaman & Polley was dissolved with Mr. Beer continuing to represent the sisters and Wes Polley, now practicing in Bisbee, Arizona, and Sterling W. Steves representing Mr. Porter. Appellant's lead counsel changed with the withdrawal of Hawkins & Miller and the appearance of Mr. Steves as lead counsel for Appellant on June 9, 1967. This was fully discussed in our main brief (p. 7-8). The Motion for Continuance should have been granted.

POINT OF ERROR II

The Trial Court erred in failing to resolve a conflict between court decisions in different states by applying the Constitutional Principles of "Full Faith and Credit."

POINT OF ERROR III

The Trial Court erred in holding that the Idaho judgment is not entitled to Full Faith and Credit and is res judicata as to each and every ground, jurisdictional and otherwise.

(A) APPELLANT DID NOT WAIVE OR ABANDON HIS CLAIM UNDER THE IDAHO DECREE

Appellees have taken the position that because Appellant did not urge his Motion for Summary Judgment prior to the time that Appellees' Motion to Dismiss was granted that Appellant waived and abandoned his claim under the Idaho decree. Appellees' argument is specious as will be quickly demonstrated

The order entered by the lower court was to grant Appellees' Motion which had been filed for summary judgment or in the alternate, to dismiss. The order entered dismissed the case with prejudice because there was no issue for the Court to try. (Tr. 87).

It is Appellant's contention that the Idaho decree was entitled to "Full Faith and Credit" and the Arizona judgment asserted as a bar by Appellees failed to follow Article IV, Section 1 of the United States Constitution.

In a word, Appellees' Motion to Dismiss traversed the Complaint and all matters filed by all parties, affidavits, exhibits, etc., were before the Court. Appellees' Motion should have been denied. Appellant does not urge that his Motion for Summary Judgment should have been granted but only that Appellees' Motion should have been denied. Certainly, Appellant did not waive the Complaint based on the Idaho decree. Appellees' argument is a non sequitur.

(B) THIS APPEAL IS NOT MOOT

Appellees assert this appeal is now moot for the reasons that after entry of judgment and prior to the transmission of the record to the Clerk of this Court, Appellees advised that they could not stipulate as to the record on appeal for the reasons that they had conveyed their interest and title in the Arizona Hotel property to the City of Phoenix, Arizona. (Tr. 99). If Appellant is successful on this appeal and this case is rendered as prayed for, with the upholding of the Idaho decree, Appellees will have conveyed a nullity to the City of Phoenix and Appellant's title will be good and those who hold from Appellees will only stand in Appellees' shoes in the chain of title.

(C) APPELLANT AS A CO-OWNER OF THE ARIZONA HOTEL PROPERTY IS A PROPER PARTY TO THIS APPEAL

Appellees assert that because the Complaint was filed by Appellant and his twin sisters doing business as the Continental Hotels Systems, a co-partnership,

that Appellant is not a proper party to this appeal from the order of dismissal. (Brief, p. 2). Appellees' position is that under Sect. 29-225, A.R.S. 1956, Appellant has no individual right in this property. In Appellees' Answer filed in the district court, Appellees denied the existence of the partnership: "Defendants deny that Plaintiffs are a copartnership d/b/a Continental Hotels System." (Tr. 2). Appellees apparently have changed their position on this issue.

Appellant claims as a co-owner of the fee title. The nature of Appellant's title to the Arizona Hotel stems from the deed given to him by Gladys Porter of Gladys' community interest in the Arizona Hotel, pursuant to the Idaho decree. (Tr. 72, XVI of Amended Facts & Conclusions of Law). Appellant's twin sisters' title stemmed from both Mrs. Gladys Porter and Appellant (Tr. 72, XV of Amended Facts and Conclusions of Law). Thus, individual deeds to the twin sisters from Gladys Porter and Appellant were provided for in the Idaho decree and a separate deed to Appellant from Gladys Porter. The sisters and Appellant are co-owners of the partnership property under Appellant's theory.

In this case, the partnership per se did not file suit but the three co-owners filed suit doing business as the Continental Hotels System. Under Arizona law, a partnership is an "association" of two or more persons to carry on as co-owners a business for profit. Sect. 29-206, A.R.S. 1956. In this case, the co-owners have all sued the Appellees to quiet title. Appellees suggest that only the legal entity has title and not the partners

under Sect. 29-225, A.R.S. 1956. No authority is cited for Appellees' proposition.

In Arizona and elsewhere, a general partnership such as this is like a joint venture except joint ventures are only for one occasion and a partnership for more than one. The partnership is not a legal entity as such but is an "association" by statute. Appellees would have this court impose a strict rule found in other jurisdictions where *limited* partnerships are found and are held to be entities such as in New York under the Partnership Law, Sect. 90 et seq. *Alley v. Clark*, 71 F.Supp 521.

Arizona has a limited partnership law, Sect. 29-301 et seq. A.R.S. 1956, but the partnership here was not of that type and even if it were it would be a strained construction to impose on an action to quiet title to say one co-owner partner, who has a direct, immediate, pecuniary, substantial interest in the suit does not have an appealable interest in a case where he may be deprived of a 2/3's interest in the title to real property. The order of dismissal deprives him of his interest and he has status and standing to seek review of the order.

In *Donroy, Ltd. v. U.S.*, (Ca 9th, 1962) 301 F.2d 200, 206, a question under the California limited partnership statute arose as to the extent of the interest of the individual partners in the limited partnership and it was held that the partners were "but an association of individuals" and that under "this concept of partnership as an association of individuals, it follows that each partner, whether general or limited

has *an interest* as such in the assets . . ." In the case at bar, a general partnership, with only general partners each owning interests in the property have an interest in the real property as a co-owner. In Arizona, Sect. 29-224(1) A.R.S. 1956 provides that The Extent of Property Rights of a Partner are: "His rights in specific partnership property." Here, Appellant seeks by this review to protect *his* interest in partnership property. Appellant has several different rights to the partnership property:

(1) the right as a co-owner to specific property such as the Arizona Hotel involved here, and

(2) his interest in the partnership as such, and

(3) the right to participate in its management. *Stilgenbaur v. U.S.*, (Ca 9th, 1940) 115 F.2d 283. Appellant seeks to protect his right and title as a co-owner of the specific real property.

(D) APPELLEES' ARGUMENT WITH REFERENCE TO THE PARTNERSHIP SUPPORTS APPELLANT

Appellees' argument that the partnership, Continental Hotels System was the Plaintiff below and not the Appellant and, therefore, Appellant has no personal property right to the partnership property supports Appellant's theory that *Porter v. Porter*, 101 Ariz. 131, 416 P.2d 564 was not res judicata to this claim.

Assuming Appellees' argument, the partnership per se was not a party to the prior Arizona action. In

order for a prior case to be a bar to the claim to quiet title, the test enunciated in *Hartford Accident and Indemnity Co. v. Jasper* (CA 9th, 1944), 144 F.2d 266, 267 must be met:

> "A matter cannot be res judicata unless there be *identity of the things sued for*, of *the cause of action*, of the *persons and parties*, the *quality of the persons for and against whom the claim is made*, and the judgment in the former action be so in point as to control the issue in the pending suit." (Emphasis supplied)

The quiet title is not a divorce action, or a suit for separate maintenance and involves the partnership which raises different issues than in *Porter v. Porter*. The Supreme Court of Arizona cited the fact that the partnership was not before the Idaho court as additional grounds for holding that not all parties were in Idaho:

> "Additional evidence that the Idaho court did not merely determine the rights of the parties before it is the fact that the partnership in which ownership of the hotel was found to be lodged was not a party before the court. Furthermore, the Uniform Partnership Act is in effect in Idaho so that a partnership can sue or be sued in its own name. Idaho Code, Sect. 53-301 et seq, Sect. 5-323. The Continental Hotels Systems partnership was not a party to the Idaho suit. Therefore, the Court was not merely adjudicating the rights of parties before it when it decided that the partnership owned the Arizona Hotel. That part of the Idaho judgment is void. *Durfee v. Duke*, 375 U.S. 106, 84 S.Ct 242, 11 L.Ed 2d 186; *Fall v.*

> *Eastin*, 215 U.S.1, 30 S.Ct 3, 54 L.Ed 65. Idaho has recognized this principle. Taylor v. Hulett, 15 Idaho 265, 97 P.37." [416 P.2d at 571]

Nor was the partnership a party in the Arizona action, an essential element of res judicata was missing in both the Idaho case and the Arizona case.

(E) FULL FAITH AND CREDIT UNDER THE UNITED STATES CONSTITUTION IS AN ISSUE IN THIS CASE

(1) DENIAL OF CERTIORARI BY THE SUPREME COURT OF THE UNITED STATES DOES NOT MEAN THAT COURT DETERMINED THE CASE

Appellees assert the theory that because the Supreme Court of the United States refused a writ of certiorari sought by Appellants' sisters subsequent to the rendition of the opinion of the Supreme Court of Arizona in *Porter v. Porter* that the refusal of the writ, in effect, means *Porter v. Porter* was "considered" and has been "determined" by the Supreme Court of the United States. This is a frequent and recurring misconception of the effect of denial of certiorari.

The denial of a writ of certiorari does not mean that the case was "considered" or "determined" by the Supreme Court of the United States. As pointed out by Mr. Justice Frankfurter in *Sheppard v. State of Ohio* (1956), 352 U.S. 910, 77 S.Ct 118, 1 L.Ed 2d

119, denial of certiorari:

> ". . . means and means only that for one reason or another this case did not commend itself to at least four members of the Court as falling within those considerations which should lead this Court to exercise its discretion in reviewing a lower court's decision. For reasons that have often been explained the Court does not give the grounds for denying the petitions for certiorari in the normally more than 1,000 cases each year in which the petitions are denied. It has also been explained why not even the positions of the various Justices in such cases are matters of public record. The rare cases in which an individual position is noted leave unillumined the functioning of the certiorari system, and do not reveal the position of all the members of the Court. See State of Maryland v. Baltimore Radio Show, 338 U.S.912, 70 S.Ct 252 94 L.Ed 562."

(2) *ERIE V. THOMPKINS* DOES NOT APPLY TO THIS CASE FOR THE REASON THAT THIS CASE INVOLVES A CONFLICT OF DECISIONS OF SISTER STATES WHICH INVOKES THE FULL FAITH AND CREDIT CLAUSE

Appellees assert that the doctrine of *Erie v. Thompkins*, 304 U.S. 64 applies to this case and, therefore, no issue of full faith and credit is involved here for the reasons that the matters have been fully litigated and *Porter v. Porter* is res judicata as to this case.

The issue here is whether this Court is bound by the Arizona Supreme Court's opinion in *Porter v. Porter* if the Arizona Supreme Court failed to give

full faith and credit to the Idaho decree.

The Arizona Supreme Court gave four reasons for failure to give full faith and credit to the prior Idaho decree:

(1) Idaho was "obligated" to give full faith and credit to the Arizona separate maintenance judgment and the "later judgment" and because of such failure the Idaho judgment [was] fatally defective because it failed to give the prior valid Arizona judgment full faith and credit and, therefore, [was] not entitled to full faith and credit by this court. [416 P.2d at 568]

(2) The Idaho judgment was not entitled to full faith and credit because the Idaho court had no jurisdiction, power or authority in the divorce proceeding to enter an order distributing Gladys' separate property and not community property. [*ibid.*].

(3) A foreign judgment will not be given a greater effect than a domestic judgment on the same issue. Citing the rule of primary of the first final judgment is a necessary incident to full faith and credit, citing *Hanson v. Denckla*, 357 U.S. 235, 256 [416 P.2d at 569].

(4) Idaho did not have power or authority and was completely without jurisdiction to establish or quiet or otherwise directly affect title to the Arizona Hotel property [416 P.2d at 569-70].

The succinct, superb dissenting opinion of Justice Udall answers the majority of three and made short shrift of the majority's reasoning which appeared to

be nothing short of a retaliatory opinion by the Supreme Court of Arizona against Idaho for failure to give credit to the prior separate maintenance order and a sheriff's sale. Justice Udall's points were swift and incisive:

1. There was never a final judgment in Arizona prior to the Idaho judgment that determined ownership of the property on the merits; therefore, Idaho did not have to give full faith and credit to a prior Arizona judgment.

2. Even assuming a valid Arizona judgment, the Idaho judgment was subsequent in time and entitled to full faith and credit.

3. Gladys waived her rights in the Arizona property when she appeared in Idaho and by sequent acts of executing quitclaim deeds and releases to Appellant and to the Porter sisters.

4. The first final determination on the merits of any interest of the Porter sisters in the Arizona property was by the Idaho court where the Porter sisters had appeared as proper parties. [416 P.2d at 572-83].

The District Court in denial of Appellant's Motion for Rehearing was of the opinion that *Erie*, *supra*, applied and that the District Court was obligated to follow the conflicts of laws rules promulgated by the Supreme Court of Arizona citing *Klaxon v. Stentor Electric Mfg Co.*, 313 U.S. 487 (1941); *Griffin v. McCoach*, 313 U.S. 198 (1941); (Tr. 91).

Both *Klaxon* and *Griffin* held that federal courts in

diversity cases are governed by the conflicts of laws of the courts where they sit.

We do not quarrel with those authorities but this case involves more than a simple diversity case. This case plainly involves the issue as to whether or not a prior decision by the Supreme Court of Idaho in *Porter v. Porter*, 84 Idaho 400, 373 Pac 2d 327 (1962) should be afforded full faith and credit under the federal constitution. In *Moore's Federal Practice*, Vol. 1A, page 3408 this comment and quote appears:

> "In United States v. Pink (1942) 315 U.S. 203, 62 S.Ct 552, 86 L.Ed 796, Chief Justice Stone, in as dissenting opinion in which Justice Roberts joined, made the following statement as to conflict of laws and full faith and credit, which seemingly is not at variance with the majority opinion:
>
> > 'In administering and distributing the property thus within their control, the New York courts are free to apply their own rules of law including their own doctrines of conflict of laws [citing the Tompkins case, Griffin v. McCoach, supra, and Kriger v. Wilson (1916) 242 U.S. 171, 176, 37 S.Ct 34, 35, 61 L.Ed 229], *except in so far as they are subject to the requirement of the full faith and credit clause—a clause applicable only to the judgments and public acts of states of the Union and not those of foreign states.*'" (Emphasis supplied)

Appellant's contention is that in this case the federal court in Arizona is bound to follow the conflict of laws promulgated by the Supreme Court of Arizona

except insofar as they are subject to the requirements of the full faith and credit clause of the federal Constitution.

In *Estin v. Estin*, 334 U.S. 541, 92 L.Ed 1078, 1 ALR 2d 1412, at 1417 the Supreme Court said:

> "The situations where a judgment of one State has been denied full faith and credit in another State, because its enforcement would contravene the latter's policy, have been few and far between. See Williams v. North Carolina, 317 US 287, 294, 295, 87 L.Ed 279, 283, 284, 63 S.Ct 207, 143 ALR 1273; Magnolia Petroleum Co. v. Hunt, 320 US 430, 438, 439, 88 L.Ed 149, 154, 155, 64 S.Ct 208, 150 ALR 413, 15 NCCANS 529, and cases cited; Sherrer v. Sherrer, 334 U.S.343 92 L.Ed (Adv 1055) 68 S.Ct 1087 1097, 1 ALR 2d 1358, supra. The Full Faith and Credit Clause is not to be applied, accordion-like, to accommodate our personal predilections. It substituted a command for the earlier principles of comity and thus basically altered the status of the States as independent sovereigns. Williams v. North Carolina, 317 U.S. 287, 301, 302, 87 L.Ed 279, 287, 288, 63 S.Ct 207, 147 ALR 1273; Sherrer v. Sherrer, 334 U.S. 343, 92 L.Ed (Adv 1055), 68 S.Ct 1087, 1097, 1 ALR 2d 1358, supra. It ordered submission by one State even to hostile policies reflected in the judgment of another State, because the practical operation of the federal system, which the Constitution designed, demanded it."

Appellant has demonstrated in its main brief under Points of Error II and III the error made by the Supreme Court of Arizona in failing to apply the Constitution's command of full faith and credit. The district

court was in error in assuming it was bound by such a decree of the Arizona Supreme Court that flaunted and made a mockery of the full faith and credit clause, rendering any hostile judgment procured in a sister state susceptible to non-enforcement in Arizona. The Idaho judgment may have been hostile, it may have been repugnant to Arizona law, but it should have been enforced by the Arizona Supreme Court and the federal district court should have denied the Motion to Dismiss the complaint premised on the Idaho decree.

As stated in *Durlacher v. Durlacher*, 123 F.2d 70 (9th Cir 1941), cert denied 315 U.S. 805, 62 S.Ct 633, 86 L.Ed 1204:

> "The Supreme Court has repeatedly held that under the full faith and credit clause of the constitution (extended by the Statute to the Court below), a judgment of a sister state must be enforced, even though the cause of action upon which the judgment is based is repugnant to the law of the state requested to enforce it . . . (Citations)"

See also *Bassett v. Bassett*, 141 F.2d 954 (9th Cir. 1944), cert denied 323 U.S. 718, 89 L.Ed 577, 65 S.Ct 47 which followed and reiterated the *Durlacher* holding by this circuit.

CONCLUSION

The foregoing amply demonstrates that the federal court in Arizona is not required to follow the Arizona conflicts law promulgated by the Arizona court where the full faith and credit clause requires enforcement of the judgment of a sister state. Appellant prays that the judgment of dismissal be reversed.

Respectfully submitted,

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200 Fort Worth Club Building
Fort Worth, Texas 76102

By: ____________________
Sterling W. Steves
Attorneys for Appellants

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules. Dated at Fort Worth, Texas the .... day of April, 1968.

STERLING W. STEVES

CERTIFICATE OF SERVICE

I certify that on the ...... day of April, 1968, I mailed three copies of Appellant's Reply Brief to the attorney for Appellees, the Honorable Richard A. Wilson, at his last known address which was at the offices of Lutich, D'Angelo & Wilson, 3120 North Third Avenue, Phoenix, Arizona, via certified mail.

STERLING W. STEVES

No. 22,522

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ROSALIO B. MONTEZ,	)
	)
Appellant,	)
	)
v.	)
	)
FRANK A. EYMAN, Warden Arizona State Prison,	)
	)
Appellee.	)

APPELLEE'S ANSWERING BRIEF

DARRELL F. SMITH
The Attorney General of the
State of Arizona

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I N D E X

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Appellant,	)
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v.	)
	)
FRANK A. EYMAN, Warden,	)
Arizona State Prison,	)
	)

JURISDICTIONAL STATEMENT

Appellee accepts appellant's jurisdictional statement.

STATEMENT OF FACTS

In addition to the facts set out in appellant's brief, appellee feels it necessary to set forth some additional factual matters to put this cause in its proper perspective.

In addition to his petition for reconsideration in the Arizona Supreme Court subsequent to this court's decision in Montez v. Eyman, 372 F.2d

[illegible]

100 (9th Cir. 1967) (T.R., Vol. 1, p. 62), appellant filed three other petitions for habeas corpus in the Arizona Supreme Court, one of which was lost, one of which was denied and one of which was denied after being treated as a petition for delayed appeal. (T.R., Vol. 1, pp. 3, 78-79)

In addition to the letters referred to in the Arizona Supreme Court Opinion, State v. Montez, 102 Ariz. 444, 432 P.2d 456, (T.R., Vol. 1, pp. 74-82), and the Second Opinion of the District Court (T.R., Vol. 1, pp. 86-95); other material consisting of letters to other attorneys, a letter to a judge, and prison mailing records were presented for consideration by the Arizona Supreme Court as regards appellant's right to appeal and his understanding and waiver thereof. (T.R., Vol. 1, pp. 70-72)

ARGUMENT

I

THE PROCEDURES FOLLOWED BY THE STATE OF ARIZONA, AND RECOGNIZED AS CORRECT BY THE DISTRICT COURT, PROVIDED APPELLANT WITH FULL EQUAL PROTECTION AND DUE PROCESS OF LAW AS REQUIRED BY THE FOURTEENTH AMENDMENT OF THE CONSTITUTION OF THE UNITED STATES.

It is important, at the outset, to determine what is not involved in the case at bar. A person convicted of a crime in Arizona has a constitutional right to appeal, as well as a constitutional right not to be required to advance any money or fees to secure any appellate rights. Arizona Constitution, Art. 2 § 24, 1 A.R.S. See also: A.R.S. §§ 13-1711, et seq.; Arizona Rules of Criminal Procedure, Rules 347-367, 17 A.R.S. A failure to perfect these appellate rights in accordance with the above cited statutes and rules which was occasioned by a cause for which the accused could not be held responsible has always been grounds for relief, either by habeas corpus, Application of Acosta, 97 Ariz. 333, 400 P.2d 328;

State v. Schroeder, 95 Ariz. 255, 389 P.2d 255, reversed Schroeder v. State, 101 Ariz. 177, 416 P.2d 974; or by a delayed appeal, Rule 16 (a), Rules of the Supreme Court, 17 A.R.S.

With these provisions in mind, the decisions cited by appellant concerning prison authorities preventing an accused from perfecting his appeal, United States v. Dowd, 180 F.2d 212 (7th Cir. 1950) vacated and remanded, Dowd v. United States, 340 U.S. 206, 95 L.Ed. 215, 71 S.Ct. 262; concerning the denial of an appeal for inability to prepay docket or filing fees, Douglas v. Green, 363 U.S. 194, 4 L.Ed.2d 1142, 80 S.Ct. 1048; and concerning failure to recognize letters requesting an appeal after formerly employed counsel wouldn't appeal unless funds were forthcoming, Newsom v. Peyton, 341 F.2d 904 (4th Cir. 1965), are simply not applicable to the case at bar. Appellant's relief has been denied because he has not shown that his failure to appeal in the proper manner was occasioned by any action other than his own careful and deliberate acts.

ARGUMENT

II

APPELLANT HAS NOT SUSTAINED HIS BURDEN OF PROOF CONCERNING HIS ALLEGED DENIAL OF HIS RIGHT TO APPEAL.

Habeas corpus is a civil proceeding in both the State and the Federal Court system, e.g. Leonard v. Eyman, 1 Ariz.App. 593, 405 P.2d 903; Estep v. United States, 251 F.2d 579 (5th Cir. 1958) and carries with it the civil burden of proof by a preponderance of the evidence by the petitioner. e.g. Beelar v. Crouse, 332 F.2d 783 (10th Cir. 1964); See Also: 28 U.S.C. § 2254 (d).

Except for petitioner's testimony in the first hearing in District Court (T.R., Vol. 2, pp. 2-23), critical portions of which were controverted by his court appointed attorney (T.R., Vol. 2, pp. 25-35); See also: Appellees Answering Brief, # 20, 963, (T.R., Vol. 1, pp. 50-54) there is no evidence probative of the fact that the decision not to appeal was not made in consultation with appellant and with his agreement, albeit a reticent and

grudging agreement. Even the letter to his attorney from the jail after conviction and before sentence, requesting a discussion about appeal which was considered and quoted by both the Arizona Supreme Court (T.R., Vol. 1, p. 75) and the District Court Judge (T.R., Vol. 1, p. 91) doesn't support his contention, when considered in light of his attorney's testimony that the matter was discussed after the receipt of this letter. (T.R., Vol. 2, pp. 29-30).

Until the filing of his habeas corpus petition in the Federal Court below, (T.R., Vol. 1, p. 1) in February of 1966, not one word was mentioned by petitioner in either his correspondence to his attorney, or in the habeas corpus petitions filed in the Arizona Superme Court (T.R., Vol. 1, pp. 78-79) concerning a denial of a right to appeal or the alleged refusal of his counsel to appeal. In other words, for a period of six and one-half (6 1/2) years, in spite of considerable correspondence to his own lawyer, other lawyers and a

judge, as well as the filing of two habeas corpus petitions in the Arizona Supreme Court, not one word was said about what is now vividly recalled and asserted to be a terrible denial of a constitutionally protected right. In addition, the brutality of the crimes (T.R., Vol. 1, p. 89), the relatively light concurrent sentences on multiple counts, and the very real possibility of heavier sentences upon retrail on the then substantial evidence (up to life imprisonment, A.R.S. § 13-643; See also: T.R., Vol. 2, pp. 34-35) makes it much more probable that appellant acquiesed in counsel's advice not to take a direct appeal, and waited for memories to fade and witnesses to disappear before launching out into the ever expanding and infinitely more fruitful area of habeas corpus, where any success at all would probably mean freedom as opposed to a possible reversal, retrail, reconviction and a new and perhaps harsher sentence.

It is just such a careful and deliberate decision, certainly now amply supported by the

evidence, which Justice Brennan has reference to in Fay v. Noia, 372 U.S. 391, 9 L.Ed.2d 837, 83 S.Ct. 822:

> "We therefore hold that the federal habeas judge may in his discretion deny relief to an applicant who has deliberately by-passed the orderly procedure of the state courts and in so doing has forfeited his state court remedies." Fay v. Noia, supra, 372 U.S. at 438, 9 L.Ed.2d at 869.

To say that the federal habeas judge in the case at bar abused this discretion on the facts available to him, would render meaningless all the efforts of the State of Arizona to insure an accused every possible opportunity to present his grievances to a proper state forum, while at the same time insuring and requiring reasonable promptness as to protect and preserve the rights of all the citizens in the integrity of the criminal justice system.

CONCLUSION

Appellant has received the full and complete consideration of all his claims in the Courts of the State of Arizona and the Courts of the United

States. The decision of the Federal District Court is amply supported by the evidence and should be affirmed.

Respectfully submitted,

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The Attorney General

Gary K. Nelson

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Assistant Attorney General

Attorneys for Appellee

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22523

DAVID LEROY DANIELS,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S OPENING BRIEF

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22523

DAVID LEROY DANIELS,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S OPENING BRIEF

JURISDICTION

This is an appeal from a judgment rendered by the United States District Court for the Eastern District of California.

The appellant was sentenced to the custody of the Attorney General for a period of three years after a one count conviction for violation of Title 50, United States Code App. Section 462 (knowingly fail and refuse to perform a duty required of him, as ordered), Universal Military Training and Service Act [Tr. 20][1], and failure to report to Local Board.

---

1. Tr. refers to the Transcript of Record.

Title 18, United States Code, Section 3231, conferred jurisdiction in the District Court over the prosecution of this case. The United States Court of Appeals for the Ninth Circuit has jurisdiction of this appeal under Rule 37 (A) (1) and (2) of the Federal Rules of Criminal Procedure. Notice of Appeal was filed in the time and manner required by law [Tr. 21].

STATEMENT OF THE CASE

The indictment charged appellant with a violation of the Universal Military Training and Service Act for refusing to perform a work assignment, as ordered [Tr. 20] and failure to report to Local Board.

Appellant pleaded "not guilty" and was tried by the Honorable Myron D. Crocker, United States District Judge, jury trial having been waived. Appellant was found guilty and sentenced to imprisonment for a period of three years [Tr. 20].

A written motion for judgment of acquittal was filed during the trial [Tr. 13].

Prior court history of this matter is set forth in *Daniels* v. *United States,* 9 Cir. 1967, 372 F.2d 407.

FACTS

Appellant was registered with the Selective Service System on November 10, 1960 [Exs. 1-2].*

*Ex. refers to the Government's exhibit, the selective service file of appellant. An Arabic number is the pagination which is found pencilled at the bottom of each sheet of the exhibit.

He signed Series VIII of the Classification Questionnaire [Ex. 7], thereby asserting he was a conscientious objector. He made the following entries in Series VII, the portion of the questionnaire relating to ministry:

"I am a minister and I have been formally ordained." [Ex. 7]. He added a full sheet of particularization to support this statement [Ex. 9].

The first (and only) classification given him was I-O, that is, conscientious objector. He requested an Appearance Before Local Board and an appeal. These were given him but both his efforts were fruitless.

Appellant's brother described the ministry activity of David, showing the following: the ministry of Jehovah's witnesses is unpaid so that each must put in some time in secular work [Rep. Tr. 15/11-....]; that "pioneering" meant nearly full-time ministry [Rep. Tr. 15/1]; that David could pioneer only for short periods, termed "vacation pioneering" because his savings wouldn't permit long periods [Rep. Tr. 15/16] and that David also had the obligation of partially supporting his mother [Rep. Tr. 16/5]; that some of the congregation of ministers were "servants", that is, leaders, and that David was one during the period of his administrative agency processing [Rep. Tr. 16/11-....]; that David also had a congregation all his own [Rep. Tr. 17/6-....].

David showed that the ministry was his vocation [Rep. Tr. 27-....] and that the work to which he was ordered required that he participate in the use of blood [Rep. Tr. 7/3 and 29/18-....] and that he be on call at all hours [Rep. Tr. 6/25 and 29/6].

QUESTIONS PRESENTED AND HOW RAISED

Each of the questions presented by this appeal was raised in the District Court by the Motion for Judgment of Acquittal filed therein [Tr. 13].

I

Was there any basis in fact for denying appellant the IV-D classification?

II

Did the government fail to prove a violation of the Act and Regulations by appellant when it failed to show that he had been ordered to suitable civilian work?

SPECIFICATION OF ERROR

The District Court erred in denying the Motion for Judgment of Acquittal.

SUMMARY OF ARGUMENT

I

Appellant presented a prima facie case for a IV-D minister's classification. No evidence whatsoever appears to rebut this claim.

II

The proof offered by the government showed that appellant was ordered to perform civilian work which conflicted (1) with his religious objections to handling blood and participating in blood transfusions, and (2) with

his commitment to his ministry, also a most obvious religious problem to him.

To thus compel a citizen to involuntarily perform a *type* of civilian work that violates his religious beliefs and commitments is a prohibition of the free exercise of appellant's religion forbidden by the First Amendment to the Constitution of the United States.

ARGUMENT

I

Appellant's Unrebutted Prima Facie Case

Appellant showed that he had worked at various secular activity to earn a living [Rep. Tr. 27/8]; that his "life's work was to be a minister" and that he "looked forward to the time when I could engage in full time ministry work and get in a field to support myself and engage in ministry full time." [Rep. Tr. 27/12].

That this "vocation" was the ministry [Rep. Tr. 28/5]; that he never took secular work that interfered with his vocation [Rep. Tr. 28/14 and 29/9].

The record undisputedly shows appellant made claim for a minister's classification and presented evidence he was ". . . a minister" and that he had ". . . been formally ordained." [Ex. 7].

There was ample corroboration [Ex. 9, 15-54].

Appellant thus presented a prima facie case for a IV-D classification (minister's status). No contrary evidence, if any existed, was ever placed in the file. There-

fore, he should have been classified in Class IV-D. It was incumbent on the board to place adverse evidence in the file, as a justification for rejecting his claim. *Dickinson v. United States,* 74 S. Ct. 152, 159.

Selective Service System regulation, 32 C.F.R., Sec. 1623.2, requires that a registrant be classified in the "lowest" class, according to a table which placed IV-D "lower" than I-O.

> 1623.2 Consideration of Classes.—Every registrant shall be placed on Class I-A under the provisions of section 1622.10 of this chapter except that when grounds are established to place a registrant in one or more of the classes listed in the following table, the registrant shall be classified in the lowest class for which he is determined to be eligible, with Class I-A-O considered the highest class and Class I-C considered the lowest class according to the following tables:

Class:	I-A-O	Class:	IV-B
	I-O		IV-C
	I-S		IV-D
	I-Y		IV-F
	II-A		IV-A
	II-C		V-A
	II-S		I-W
	I-D		I-C
	III-A		

Regulation 32 C.F.R. § 1622.43 governs classification of registrants presenting evidence for a minister's status.

1622.43 Class IV-D: Minister of Religion or Divinity Student.—(a) In Class IV-D shall be placed any registrant:

(1) Who is a regular minister of religion;

(2) Who is a duly ordained minister of religion;

(3) Who is a student preparing for the ministry under the direction of a recognized church or religious organization and who is satisfactorily pursuing a full-time course of instruction in a recognized theological or divinity school; or

(4) Who is a student preparing for the ministry under the direction of a recognized church or religious organization and who is satisfactorily pursuing a full-time course of instruction leading to entrance into a recognized theological or divinity school in which he has been pre-enrolled.

(b) Section 16 of Title I of the Universal Military Training and Service Act, as amended, contains in part the following provisions:

"Sec. 16. When used in this title— * * * (g) (1) the term 'duly ordained minister of religion' means a person who has been ordained, in accordance with the ceremonial, ritual, or discipline of a church, religious sect, or organization established on the basis of a community of faith and belief, doctrines and practices of a religious character to preach and to teach the doctrines of such church, sect, or organization and to administer the rites and ceremonies thereof in public worship, and who as his regular and customary vocation preaches and teaches the principles of religion and administers the ordinances of public worship as embodied in the creed or principles of such church, sect, or organization.

"(2) The term 'regular minister of religion' means one who as his customary vocation preaches

and teaches the principles of religion of a church, a religious sect, or organization of which he is a member, without having been formally ordained as a minister of religion, and who is recognized by such church, sect, or organization as a regular minister.

"(3) The term 'regular or duly ordained minister of religion' does not include a person who irregularly or incidentally preaches and teaches the principles of religion of a church, religious sect, or organization and does not include any person who may have been duly ordained a minister in accordance with the ceremonial, rite, or discipline of a church, religious sect or organization, but who does not regularly, as a vocation, teach and preach the principles of religion and administer the ordinances of public worship as embodied in the creed or principles of his church, sect, or organization."

"Vocation" is the chief consideration. "Full-time" is nowhere mentioned; nor is "part-time" mentioned. Nor is the word "Pioneer" or any equivalent expression used. Neither hours of activity nor clerical title are recognized by the Act or the regulations as factors in classifying.

Ministerial activity that is "irregular" is stated to be a disqualification. This consideration does not apply here. Appellant's uncontradicted evidence is that he regularly performed enumerated clerical activity.

The only other disqualifying consideration mentioned by law is "incidental". Here there was no finding by the board on this factor. Appellant's factual and relevant testimony was to the contrary. None was rebutted. The final step of his processing by the Selective Service Sys-

tem shows that he didn't regard his ministerial work as incidental to other work but as something so important to him that he willingly faced a prison term when it became clear that the I-O classification given him would interfere with his obligation to Jehovah.

Thus, there can be no doubt that appellant Daniels made out a prima facie case, and an unrebutted one. See *Wiggins* v. *U. S. A.*, 5 Cir., 1958, 261 F.2d 113.

II

The Work to Which Appellant Was Ordered Was Inappropriate in That It Involved Elements Contrary to His Religion.

Appellant testified that he had reason to believe that the work the local board ordered him to do, at the Los Angeles General Hospital, would or might interfere with his commitment to his ministry in that he would "have to be on call, in other words, at all times and we would have no week-ends free." [Rep. Tr. 29/6].

He also testified that he had learned he would have to handle blood and that this was against his religion [Rep. Tr. 29/25].

Appellant was ordered to do his civilian work at the Los Angeles County Department of Charities. Before being so ordered the State Director had asked the Director for such authority, stating that the work was "suitable". The Director approved.

We do not contend that this work did not meet all the statutory requirements, in general.

We contend that it was not suitable, in particular, that is, as an assignment to this appellant.

The law provides that work assigned shall be "appropriate." [32 C.F.R. § 1660.1]. Where the registrant does not agree to the type suggested to him by the Selective Service System an arbitration-type of meeting is arranged [32 C.F.R. § 1660.20(c)].

Our objection is that the work ordered involved duties contrary to his religious beliefs. His unrebutted testimony showed that the work interfered with his religious (ministry) commitment because of the hours [Rep. Tr. p. 29, lines 6-....].

He also showed that the work offered would involve handling blood, contrary to his religious belief and the well-known beliefs of the Jehovah's witnesses [Rep. Tr. 29/25].

Work religiously objectionable has been held inappropriate for the alternate service contemplated by Congress.

In *United States* v. *Copeland,* D. Conn. 1954, 126 F. Supp. 734, it was held that work that adversely affected the religious beliefs of a registrant was inappropriate.

Likewise, in *United States of America, Plaintiff* v. *George Donald Sparks, Defendant,* Criminal No. IP-54-CR-30 decided by Honorable William E. Steckler, district judge, Southern District of Indiana, Indianapolis Division on February 11, 1955, the court held that the work to which Sparks had been ordered "clashed with those of the sectarian principles of the defendant" and therefore acquitted him.

CONCLUSION

For the reasons stated above, it is respectfully submitted that the judgment of the District Court should be reversed and the cause remanded with instructions to grant the petition for writ of habeas corpus.

Respectfully submitted,

J. B. Tietz
Attorney for Appellant

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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April 22, 1968

NO. 22523

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DAVID LEROY DANIELS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

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APPELLEE'S BRIEF

I

JURISDICTIONAL STATEMENT

Appellant, DAVID LEROY DANIELS, was indicted by the Federal Grand Jury for the Northern Division of the Southern District of California on June 17, 1965, under No. 4187-CD [C. T. 1-2]. 1/ The indictment charged a violation of Title 50 App., United States Code, Section 462, Universal Military Training and Service Act, Failure to Report to Local Board.

Appellant was originally tried without a jury before the Honorable M. D. Crocker, U. S. District Judge, on June 18,

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1/ "C. T." refers to Clerk's Transcript of Proceedings.

1965 and found guilty as charged. Subsequently, the appellant's conviction was reversed on appeal [2/] and he was retried without a jury before the same court on August 4, 1967. Appellant was again found guilty as charged and on September 29, 1967, was sentenced to the custody of the Attorney General of the United States for a period of three years [C. T. 20].

Appellant's Notice of Appeal was timely filed on October 9, 1967 [C. T. 21].

The jurisdiction of the District Court was based upon Title 50 U. S. C. App. §462, Title 18 U. S. C. §3231 and Rule 18 of the Federal Rules of Criminal Procedure. This Court has jurisdiction to review the judgment of the District Court pursuant to Title 28 U. S. C. §§ 1291 and 1294 and Rule 37(a) of the Federal Rules of Criminal Procedure.

II

STATUTE INVOLVED

Title 50 U. S. C. App. §462, provides in pertinent part as follows:

> "Any member of the Selective Service System or any other person charged as herein provided with the duty of carrying out any of the provisions of this title . . . or the rules or

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2/ See Daniels v. United States, 372 F. 2d 407 (9th Cir. 1967).

regulations made or directions given thereunder, who shall knowingly fail or neglect to perform such duty . . . or who otherwise evades or refuses . . . service in the armed forces or any of the requirements of this title . . . or who in any manner shall knowingly fail or neglect or refuse to perform any duty required of him under or in the execution of this title . . . or rules, regulations or directions made pursuant to this title . . . shall, upon conviction in any district court of the United States of competent jurisdiction, be punished by imprisonment for not more than five years or a fine of not more than $10,000, or by both. . . ."

III

QUESTIONS PRESENTED

1. Was the appellant legally entitled to a classification as a Minister of Religion or divinity student (IV-D)?

2. May the appellant now claim that the work to which he was assigned was inappropriate, after refusing to designate any work he would perform in lieu of military service?

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

IV

STATEMENT OF FACTS

At the commencement of the trial of this case a paginated photographic copy of the official Selective Service File of appellant was offered and admitted in evidence as Government's Exhibit No. 1 [R. T. 3/17-24]. 3/ This copy had attached to it a certificate by Major Malcolm F. Miller, U. S. A. F., District Coordinator, Selective Service System, Los Angeles, California, that it was a full, true and correct copy of the original file of which he had legal custody. Also attached was a certificate and seal of Captain T. D. Proffitt, USAF (Ret.), Area Coordinator, Selective Service System, Los Angeles, California to the effect that Major Miller was the District Coordinator and had legal custody of the original selective service file of the appellant.

This file revealed the following events with respect to appellant's registration status in the Selective Service System:

On November 10, 1960, appellant registered with Local Board 68, hereinafter referred to as the Board (Ex. 1, pp. 1-2).

On October 9, 1963, the Board received from appellant a completed Classification Questionnaire (Form SSS No. 100) (Ex. 1, pp. 4-9), wherein appellant stated in response to Series VIII- Conscientious Objector, that he claimed exemption from military service as a conscientious objector (Ex. 1, p. 7).

3/ "R. T." refers to Reporter's Transcript of Record.

[illegible]

On October 21, 1963, the Board received a completed special form for Conscientious Objector (SSS Form No. 150) (Ex. 1, pp. 47-50).

On November 19, 1963, the Board, by a vote of 2-0, classified appellant in Class 1-O. On the same date a notice of such classification was mailed to appellant (SSS Form 100) (Ex. 1, p. 11).

On November 26, 1963, the appellant appealed his classification to the Appeal Board and requested a personal appearance (Ex. 1, p. 57).

On February 10, 1964, appellant appeared for a personal interview at the Board, at which time he stated that he spent 17 to 18 hours per week as a Jehovah Witness Minister, was not a "Pioneer", and could not accept cilivian work. On this same date the Board again classified appellant in Class 1-O (Ex. 3, p. 11). On February 12, 1964, notice of his classification was mailed to appellant (SSS Form No. 110) (Ex. 1, pp. 11, 61).

On May 15, 1964, appellant was ordered to report for an Armed Forces Physical Examination (Ex. 1, p. 62). On June 2, 1964, the appellant reported for the physical examination (Ex. 1, pp. 63-73), and was found physically acceptable (Ex. 1, p. 74).

On July 2, 1964, pursuant to appellant's appeal of his classification, his file was forwarded to the Appeal Board (Ex. 1, p. 75). On July 23, 1964, the Appeal Board, by a vote of 3-0, classified appellant 1-O (Ex. 1, p. 76). On July 28, 1964, appellant was mailed a notification of his classification (SSS Form

110) (Ex. 1, p. 11).

On August 11, 1964, the appellant returned uncompleted Special Form for Class 1-O Registrants (SSS Form 152), in which, in response to a request for a choice of three civilian job assignments, Series I-Work Qualifications, he stated that he could not accept any work due to his religious beliefs (Ex. 1, pp. 77-80 at p. 78).

On September 8, 1964, the appellant was mailed a letter offering him three types of civilian work in lieu of induction (Ex. 1, p. 85).

On September 21, 1964, the Board received from appellant its September 8, 1964 letter, returned with the statement signed by appellant "I do not wish to perform any of the types of work listed above". In an attached letter appellant stated in substance his conscientious objection to such work (Ex. 1, pp. 85, 86).

On November 16, 1964, appellant appeared at the Board for a meeting to attempt to reach an agreement on an approved civilian work assignment. At the meeting he stated he would refuse any approved job under this program offered by the Board, as being contrary to his belief (Ex. 1, pp. 90, 91, 92). The appellant further signed a statement that he "will refuse to report for work of national importance if ordered to do so by my own local board or by any other local board" (Ex. 1, p. 92).

On December 11, 1964, the Board mailed to appellant an order to report to the Board at 8:00 a.m. on January 4, 1965,

where he would be given instructions to proceed to a place of civilian work contributing to the maintenance of national health, safety or interest. The Board at that time specified the Los Angeles Department of Charities, 1200 North State Street, Los Angeles, California, as an approved civilian work assignment (Ex. 1, p. 99).

On January 4, 1965, appellant failed to appear at the Board or at the Los Angeles Department of Charities (Ex. 1, pp. 98, 99).

V

ARGUMENT

A. APPELLANT DID NOT MAKE OUT A PRIMA FACIE CASE FOR A MINISTERIAL EXEMPTION; THEREFORE THERE WAS A BASIS IN FACT FOR A CONSCIENTIOUS OBJECTOR CLASSIFICATION.

1. Judicial consideration of appellant's classification must be limited to the question of whether or not there was a basis in fact for the classification given the appellant by his local board. It is well settled that judicial review of a registrant's classification is exceedingly narrow and limited in scope. Congress has provided that the decisions of local boards shall be final, except in certain instances.

Title 50 App. U.S.C. §460(b)(3).

The Supreme Court took the position in United States v. Estep, 327 U.S. 114, 122 (1946) that the jurisdiction of the local board is reached only if there was no basis in fact for the classification given to the registrant. The Supreme Court has reiterated the stand adopted in Estep in subsequent decisions. Attention is direct to Eagles v. United States, ex rel Samuels, 329 U.S. 304 (1946); Gibson v. United States, 329 U.S. 338 (1946); Cox v. United States, 332 U.S. 442 (1947); United States v. Nugent, 346 U.S. 1 (1953); Dickinson v. United States, 346 U.S. 389 (1953); and Witmer v. United States, 348 U.S. 375 (1955).

In the case of Swaczyk v. United States, 156 F.2d 17, 19 (1st Cir. 1946), cert. denied 329 U.S. 726, the court stated:

> " 'It should be remembered that immunity from military service arises not as a matter of constitutional grant, but by virtue of Congressional deference to conscientious religious views . . . . The burden, therefor, is not upon the Government, but upon one claiming exemption to bring himself clearly within the exempted class . . . .
>
> "Unless, then the registrant can establish the complete lack of a factual basis for his classification, or, perhaps, some controlling bias or prejudice against him, his defense is ineffectual . . . .' "

Having thus set forth the foregoing fundamentals, consideration must next be given to the question of whether the local

board's denial of a ministerial exemption to the appellant is without any basis in fact.

2. The appellant did not establish that he is nor has he claimed to be, a leader of a Jehovah's Witness Congregation. He bases his claim for a ministerial exemption on the fact that he is recognized as an ordained minister by his sect. The issue thus raised is whether any of the members of Jehovah's Witnesses meet the statutory criteria for ministerial exemption.

The Universal Military Training and Service Act exempts from military training and service persons who are regular or duly ordained ministers of religion. See 50 U.S.C. App. §456. These terms are defined in 50 U.S.C. §466(g) as follows:

> "(1) The term 'duly ordained minister of religion' means a person who has been ordained, in accordance with the ceremonial, ritual, or discipline of a church, religious sect, or organization established on the basis of a community of faith and belief, doctrines and practices of a religious character, to preach and to teach the doctrines of such church sect, or organization and to administer the rites and ceremonies thereof in public worship, and who as his regular and customary vocation preaches and teaches the principles of religion and administers the ordinances of public worship as embodied in the creed or principles of such church, sect, or organization.

"(2) The term 'regular minister of religion' means one who as his customary vocation preaches and teaches the principles of religion of a church, a religious sect, or organization of which he is a member, without having been formally ordained as a minister of religion, and who is recognized by such church, sect, or organization as a regular minister.

"(3) The term 'regular or duly ordained minister of religion' does not include a person who irregularly or incidentally preaches and teaches the principles of religion of a church, religious sect, or organization and does not include any person who may have been duly ordained a minister in accordance with the ceremonial, rite, or discipline of a church, religious sect or organization, but who does not regularly, as a vocation, teach and preach the principles of religion and administer the ordinances of public worship as embodied in the creed or principles of his church, sect, or organization."

Senate Report No. 1268, 80th Congress, 2d Session, dated May 12, 1948, offers substantial insight into the legislative intent and purpose behind the Act. This report states at page 13:

" . . . Serious difficulties arose in the

administration and enforcement of the 1940 Act because of the claims by members of one particular faith that all of its members were ministers of religion. A minority of the Supreme Court thought that Congress intended to grant an exemption broad enought to include this group. (See the dissenting opinions in Cox v. United States, 332 U.S. 442, 455, 457 [68 S. Ct. 115, 92 L.Ed. 59]). In order that there may be no misunderstanding of the fact that the exemption granted is a narrow one, intended for the leaders of the various religious faiths and not for the members generally, the terms 'regular or duly ordained ministers of religion' have been defined in section 16(g). The definition is that which was contained in the 1917 Selective Service Regulations and which was successfully administered without the problems which arose under the 1950 Act." (Emphasis added).

The view of the majority in Cox v. United States, 332 U.S. 442, decided under the 1940 Act, was given subsequent approval in the above quoted legislative history of the 1948 Act. It is clear that Congress had the Jehovah's Witnesses in mind in reverting to the 1917 definition of 'regular or duly ordained ministers of religion.'

The Supreme Court has held that no person can be

classified as a minister merely because of some title which he holds in the sect of which he is a member. In effect the court held in Dickinson v. United States, supra, that regardless of title each person claiming a ministerial exemption must be measured against the rigid statutory requirements provided by Congress. The court stated at page 394:

> "The ministerial exemption, as was pointed out in the Senate Report accompanying the 1948 Act, 'is a narrow one, intended for the leaders of the various religious faiths and not for the members generally.' S. Rep. No. 1268, 80th Cong., 2d Sess. 13. Certainly all members of a religious organization or sect are not entitled to the exemption by reason of their membership, even though in their belief each is a minister. Cf. Cox v. United States, 332 U.S. 442 [68 S. Ct. 115, 92 L.Ed. 59] (1947). On the other hand, a legitimate minister cannot be, for the purposes of the Act, unfrocked simply because all the members of his sect base an exemption claim on the dogma of its faith. That would leave a congregation without a cleric. Each registrant must satisfy the Act's regid criteria for the exemption. Preaching and teaching the principles of one's sect, if performed part-time or half-time, occasionally or irregularly, are insufficient to bring a registrant under §6(g). These activities must be

> regularly performed. They must, as the statute reads, comprise the registrant's 'vocation'. And since the ministerial exemption is a matter of legislative grace, the selective service registrant bears the burden of clearly establishing the right to the exemption."

It is inconceivable that Congress intended to include within its definition of ministers one hundred percent of any congregation. Many lay officials in various religious denominations devote long hours and much energy to their religious activities without claiming that they are thereby made ministers of religion.

Turning to the evidence in the instant case and guided by the foregoing standards, it is clear that the appellant was not engaged in ministerial activity as a "regular and customary vocation". By the appellant's own words, the longest consecutive period prior to January 1, 1965, that he was employed as a pioneer or a vacation pioneer was two months [R. T. 34/3]. (A Pioneer must devote 100 hours a month to ministerial activities in the field. In computing the 100 hours, time spent in reading or preparation for field work is not counted. Vacation Pioneers are appointed for a two-week to three-month period and are not regarded as regularly appointed, full Pioneers.) 4/ Burnis L. Daniels, the

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4/ See R. T. 15, 18, 19 and United States v. Tettenburn, 186 F. Supp. 203, 208 (D. C. Md. 1960).

appellant's brother, stated that the appellant served as a vacation pioneer "at some times" [R. T. 18/15], and further stated that on the average the appellant spent 30 hours a month in the actual ministry itself [R. T. 19/12-13]. And, even while he was engaged as a vacation pioneer, the appellant was gainfully employed [R. T. 34].

The appellant further stated that during his life, up to 1965, he looked forward to the time when he "could engage in full time ministry work" and get in a field to support himself and engage in ministry full time [R. T. 26/18-20, 27/12-15]. Thus, judging from the testimony adduced at the trial, at no time up to the time he refused to report for civilian employment, was the appellant engaged in full-time ministerial work.

This conclusion is further buttressed by Exhibit 1, the appellant's selective service file. At the time the appellant filed his Classification Questionnaire, October 9, 1963, he was working an average of 40 hours a week packing and shipping raisins (Ex. 1, p. 6). He stated at that time that time that his goal was to become a "full time pioneer," i. e., one who devotes 100 hours a month to field work (Ex. 1, p. 9). At the time of his personal appearance before the local board on February 10, 1964, to express his dissatisfaction with his 1-O classification, he stated that he was not a Pioneer, although he had served as a vacation Pioneer, that he was unemployed and is looking for work, and that he spent from 17-18 hours per week as a minister (Ex. 1, p. 61). This is consistent with the statement he made to the board on October 21,

1963, when he filed his Special Form For Conscientious Objector, when he acknowledged spending 20 hours a week in ministerial activities (Ex. 1, p. 48, item 6), which time is stated to include both study and field work. These activities apparently included serving as a Congregation Book Study Conductor, wherein he had oversight of fifteen people (Ex. 1, p. 49, series IV, item 3, R. T. 19/17-18) but not as a Congregation Servant, who is the presiding minister and overseer of all congregation activities.

On November 16, 1964, appellant was interviewed pursuant to 32 C. F. R. §1660. 20 to determine the type of civilian employment best suited for him. At that time the appellant indicated that he was averaging approximately 14 hours a week in ministerial work (Ex. 1, p. 91).

It is clearly evident that despite his declarations to the contrary (App. Br. pp. 5, 8), appellant did not engage in ministerial work in the Jehovah's Witnesses as a vocation. And while appellant further argues that the Act does not use the words "full time" (App. Br. p. 8), it can scarcely be contended that one cannot pursue a vocation without devoting all or substantially all of one's time thereto.

It is submitted that appellant is expressly covered by the language of 50 App. U. S. C. §466(g)(3), supra, p. 10. Reviewing the evidence as to the appellant's ministerial activity, when measured against the evidence submitted by defendants in other cases, it must be concluded the appellant is no more convincing in his claim than others have been. In the Cox case, supra, the

Supreme Court affirmed the convictions of three registrants. The first one, Cox, had information in his file showing that he averaged 150 hours a month in religious activities outside of his secular work. Another registrant, Thompson, had information in his file indicating that he had devoted over 500 hours to field service; however, he submitted no evidence of changed activity in operating his grocery store. The file of a third registrant, Roisum, who was a Book Study Conductor, as was the appellant here, showed that his secular activity was farming.

The Ninth Circuit in Badger v. United States, 322 F. 2d 902 (1963) upheld the board's denial of a ministerial exemption to a Jehovah's Witness registrant who at one point was devoting 30 to 35 hours per month to the ministry and, at another point, 20-25 hours per week. The court specifically determined, at page 908, that under such circumstances "the board would have been justified in concluding that appellant's work as a minister was still not vocational". The Ninth Circuit followed Badger in the very recent case of Langhorne v. United States, No. 21,910, decided April 29, 1968, wherein the court denied a ministerial exemption to a Jehovah's Witness who devoted not more than ten hours a week to ministerial work.

Other circuits have reached the same conclusion. See e. g. Neal v. United States, 203 F. 2d 111 (5th Cir. 1953), cert. denied 345 U. S. 996; Bradshaw v. United States, 242 F. 2d 180 (10th Cir. 1957); Capehart v. United States, 237 F. 2d 388 (4th Cir. 1956); and United States v. Diercks, 223 F. 2d 12 (7th Cir. 1955).

3. It is thus submitted that the local board's decision to deny the appellant a ministerial exemption and classify him as a conscientious objector was not without basis in fact and, further, that a holding in this case to that effect would be in line with the Ninth Circuit's decision in Badger and Langhorne, supra, other circuit decisions and the decisions of the Supreme Court. Far from making out a prima facie case for a ministerial exemption, appellant's claim thereto is clearly rebutted by the evidence in his file and the testimony adduced at trial.

Appellant cites the Dickinson case supra for the proposition that "[i]t was incumbent on the board to place adverse evidence in the file, as a justification for rejecting his claim." (App. Br. p. 6). This point was also raised in the Badger case, supra, and since the court's response covers the situation at bar, it is quoted in its entirety:

> "The Dickinson case points out that local boards are not courts of law bound by traditional rules of evidence and that they are given leeway in hearing and considering a variety of material as evidence. Moreover, the registrant bears the burden of clearly establishing an exemption. Reviewing courts may insist, however, that there be some proof that is incompatible with the registrant's proof of exemption. Therefore, is proof exists in the record before us which is incompatible with appellant's claim, the evidentiary burden of the

board is satisfied under the Dickinson case."

Badger v. United States, supra, at p. 906

(Emphasis added).

As pointed out above, appellant's file is replete with evidence which is incompatible with his claimed ministerial exemption. Therefore, his claim must fall. It cannot be said that appellant produced any evidence, beyond a mere title of "Minister", which all Jehovah's Witnesses hold, to show that he occupied a position of spirtual leadership and that the preaching and teaching of his religion was his customary vocation.

Appellant also cited Wiggins v. United States, 261 F.2d 113 (5th Cir. 1958) in support of his position that he is entitled to a ministerial exemption (App. Br. p. 9). It is submitted that this is not controlling, in view of the decisions of the Supreme Court in the Cox and Dickinson cases, supra, the intention of Congress as set out previously in this brief, and the decisions in this and other circuits cited above.

4. Lastly, it should be pointed out that in a memorandum to the National Selective Service Appeal Board, dated June 25, 1958, Mr. Hayden C. Covington, General Counsel for Jehovah's Witnesses, advised that it would not be the policy of the Jehovah's Witnesses to press for ministerial status for anyone below the rank of Pioneer. Mr. Covington's comments in this regard are as follows: 5/

5/ See United States v. Tettenburn, supra, at 208-209.

"19. Will the Society agree that it will not press for ministerial status for anyone under the rank of pioneer?

"Yes, except in the case of the congregation servant who is devoting a substantial amount of his time, not as a pioneer, which together with his duties as a congregation servant makes his ministry his vocation and not his avocation. The Society is interested in defending only those persons who qualify for the exemption under the law of the land. On such basis it does not contend that every minister in the organization is entitled to the exemption. Only those ministers who meet the definition of vocation required by the statute are entitled to be given the exemption and these the Society can legally defend."

Appellant thus can scarcely contend that he is entitled to a ministerial exemption in the face of a clear policy pronouncement by the Watchtower Bible and Tract Society (the governing body for Jehovah's Witnesses) that only those ministers who meet the definition of vocation required by the statute are entitled to the exemption. It is interesting to note that the testimony of appellant's brother on this point is directly contrary to the foregoing policy statement [R. T. 23/25, 24/1-4].

B. APPELLANT'S REFUSAL TO DESIGNATE APPROPRIATE CIVILIAN EMPLOYMENT PRECLUDES HIS CLAIM THAT THE WORK TO WHICH HE WAS ASSIGNED WAS INAPPROPRIATE.

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1. Appellant's selective service file reveals that at no time during his processing before the board did he agree to perform any civilian work in lieu of military service. In the Special Report For Class 1-O Registrants, filed August 11, 1964, appellant stated that he could not "perform any such work due to my standings and beliefs." (Ex. 1, p. 78). Appellant refused to perform three types of work suggested to him by the board on September 8, 1964 (Ex. 1, p. 85), explaining that to do so would be "still contributing to the interests of the Government." (Ex. 1, p. 86). During an interview arranged under the provisions of 32 C.F.R. §1660.20(c), appellant again refused to perform any work suggested to him, did not suggest any work he was willing to perform and stated that he was unwilling to perform any work as a 1-O registrant and would refuse to report for work of national importance if ordered to do so by his or any other board (Ex. 1, pp. 90-92). Following this interview, it was determined that work as an Institutional Helper at the Los Angeles Department of Charities was appropriate and was available (Ex. 1, p. 91).

This position of resolute refusal to perform any work of national importance was also taken by the appellant during his trial [R. T. 28-33]. Appellant further elaborated on his stand by stating

that he objected to being on call [R. T. 29/4-8] and objected to the handling of blood [R. T. 29/22-25, 30/1-4].

2. It is submitted that this issue is covered aptly by the Ninth Circuit's comments in the case of Langhorne v. United States, supra, where the court held:

> "Section 456(j) of Title 50 App. U.S.C. provides that a person classified as a conscientious objector may be 'ordered . . . to perform . . . such civilian work . . . as the local board may deem appropriate . . . .' Appellant, after taking the position throughout the administrative hearing and at the trial that he was not going to perform any work in lieu of military service, now argues that the work to which he was assigned was not appropriate. If we assume that the word 'appropriate' means appropriate to the particular registrant, and if we make the violent assumption that the objections now made are otherwise valid, they come too late. The regulations give the registrant an opportunity to participate in the selection of an appropriate assignment. Appellant, given all of the opportunities provided by the regulations, neither suggested an appropriate assignment nor made specific objections to assignments suggested by the selective service personnel. We hold that a registrant may not overturn the action of the board

ordering him to work on any ground not disclosed to the board. A registrant may not, as did appellant, refuse any work and then later conjure up objections to the work assigned."

Appellant relies on United States v. Copeland, 126 F. Supp. 734 (D.C. Conn., 1954) to support his position that work which adversely affects the religious beliefs of a registrant is inappropriate. However, the Ninth Circuit has previously distinguished and questioned the Copeland decision. See Yaich v. United States, 283 F.2d 613, 619 (9th Cir. 1960) and Johnson v. United States, 285 F.2d 700, 702 (9th Cir. 1960). The Copeland case has been expressly rejected by the Seventh Circuit. See United States v. Hoepker, 223 F.2d 921 (1955), cert. denied 350 U.S. 841.

Work as an Institutional Helper in the Los Angeles Department of Charities has many times been adjudged competent as civilian employment in lieu of induction. See Yaich v. United States, supra, at p. 619 and cases there cited.

The evident conclusion to be drawn from the foregoing authorities is that appellant's argument on this issue is without legal merit.

VI

CONCLUSION

For the foregoing reasons it is requested that the decision of the trial court be affirmed.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Arnold G. Regardie
ARNOLD G. REGARDIE